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## THE TAX REVIEW

APRIL
1954

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# The Canadian Chartered Accountant

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## THE TAX REVIEW




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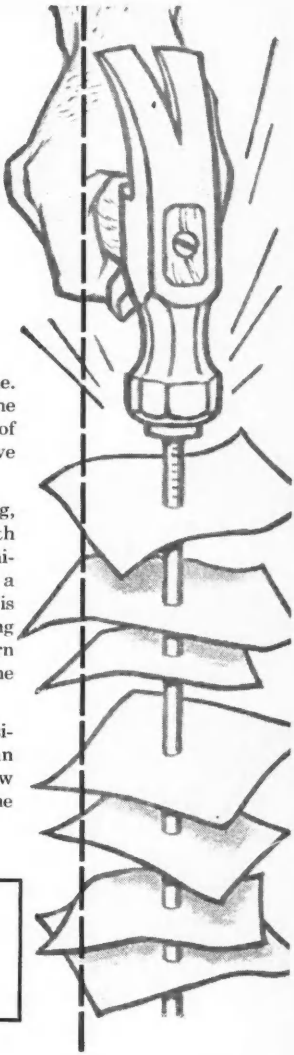

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# SWEETNESS and LIGHT

*By Jay Vee*

### On the Record

WHEN our learned M.P.'s set themselves to revising the Criminal Code they come up with all sorts of highly useful information. We quote from *Hansard* of February 12 which reports their debate on clause 160—*Causing Disturbance*:

**Mr. Winch (Vancouver East):** . . . I have seen the Ontario liquor permits, although I have not one myself, and on the opening page it is stated that it is an offence to permit drunkenness in your own home, or in your room in the hotel.

. . . . . .

**Mr. McIvor (Fort William):** Is there any place where it is lawful for a man to get drunk?

**Mr. Nesbitt (Oxford):** The House of Commons.

**Mr. Fulton (Kamloops):** The House of Commons is absolutely privileged in that regard.

**Mr. Winch:** I have an idea that it is a civil right.

Well, at least it's something to keep in mind next time you are in Ottawa!

### Collector's Item

"HAVE you any wheels today?" was the unexpected question which a bejeaned ten-year-old put to the proprietor of our corner cigar and candy store as we were browsing through the pocket books. We had our mouth open to suggest that he go to a bicycle repair shop when, to our surprise, the proprietor handed him a package of bubble

gum from the tiers of candy bars. While our mouth opened still wider, the lad tore the package apart and pulled out four coloured cards. "I have this one and this one," he said, "so I'll trade them off. But I need this Panhard Racer and this here one my kid brother wants." He stuffed all four into various pockets according to classification, handed over a coin, and was gone.

By this time we were really in a daze, but the friendly proprietor took pity on us. "Have you ever seen those wheel cards?" he asked, as he slit a couple of boxes. "Each one shows and describes an old or new model car. You can get anything from a Haynes-Apperson Light Touring to a Willys Aero-Falcon. There are about 160 cards all told, and right now the youngsters are in quite a dither to collect them."

At random we picked No. 4 — Buick Toy Tonneau 1910 and learned that it had four cylinders, 18 horsepower, 92-inch wheelbase, and cost $1,150 new. It was also a fine example of the "overhead valve engine" (whatever that means). Then we chanced upon No. 159 — Thomas Flyer Limousine 1904 which, for variety we suppose, had three cylinders, 24 horsepower, 92-inch wheelbase, and cost $3,000 new.

"What a lot of gum you would have to chew to get a set together," was the closest we could come to an intelligent comment.

"They don't bother with the gum," sighed the proprietor as he picked up a grimy pink piece from the floor, "and they're always swapping back and forth to get rid of the duplicates." According to him the activity on the floor of the New York stock exchange has nothing on the frantic dickering that is currently going on in the schoolyards at recess.

Spring and baseball will soon be upon us, and no doubt "wheels" will then go out of fashion. But right now with the small types on our block, the absolute *dernier cri* is "Trade you, trade you, trade you"!

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## COMMENT AND OPINION

### Accountants in the Courts

NOT many chartered accountants have attained the fame, a fame which nobody wishes, of having their names immortalized in the law reports as plaintiffs or defendants in court proceedings. In recent months, however, the names of three chartered accountants have been added to the list, two of them in Canada, one in England. One of these cases concerned an auditor's right to a lien on his client's books of account for payment of his fee, the second concerned the proper amount of an accountant's fee for professional services, and the third concerned the right of a dismissed audit clerk who was defendant in an action brought by his former employers, a firm of chartered accountants, to compel the latter to produce for his inspection documents in their possession relating to the audit of one of their clients.

The auditor's claim for a lien on the books of account of his client, which was a limited company, failed, and though it is most unlikely that many of our readers will ever wish to assert a similar claim, we imagine they will be interested in knowing why that of their colleague was rejected by the Court.

An auditor, said County Judge Edwards of Calgary, has no general lien entitling him to retain the books, documents, and other chattels entrusted to him from time to time until *all* his claims or accounts against the owner have been paid, such as is possessed by solicitors, bankers, factors, and stockbrokers; he is, however, entitled to a particular lien on clients' books of account for services rendered on them after he has obtained possession of them provided that he maintains continued possession of the books, but he has no right of lien if the books are the property of a limited company required by statute to keep its books of account at its registered office.

The second Canadian case, concerning the amount of the accountant's fee, is most interesting. The accountant in that case had been commissioned to make an investigation of the affairs of a company of which his client was a minority shareholder to ascertain whether the controlling shareholders were operating the company to his detriment by funnelling some of the profits into three new companies which they had formed to carry on related businesses. The accountant, who had a special knowledge of the particular business involved, made an investigation and on his advice and with his assistance an agreement was reached for the exchange of the client's common shares which had a book value of $52,800 for cumulative preference shares of a par value of $95,000 and $15,000 in cash. The accountant fixed

his bill at $11,000, being 10% of the par value received by the client. The client contended, firstly, that the accountant had agreed to be paid at the rate of $7 per hour for time expended (111 hours according to the evidence). No such agreement was, however, proved and the client's second submission was that the fee should not be based on a percentage of the total amount received but on the amount by which his financial position was improved by the accountant's services.

The action was tried in the Ontario High Court before Mr. Justice McLennan who awarded the accountant the sum of $5,500 as a fair and reasonable fee. His judgment concluded with this paragraph:

> In arriving at the amount I have considered the following factors: the professional status of the plaintiff, his special skills or ability arising from his experience, the responsibility involved in the work he did, and the result of that work and the time occupied. In allowing the amount to the plaintiff that . . . I do, I am not doing so on a percentage basis of any kind, either of the total amount involved or a percentage of the improved position. I think to do so would defeat the very principles on which I think a quantum should be arrived at, and that is "all factors essential to fair play and justice" (per Middleton J. in *Re Sobritor* (1920) 47 O.L.R. 522 at p. 524).

The third case is an English decision, and we are indebted to our contemporary *The Australian Accountant* for its abbreviated report of the judgment. In that case the relationship between a firm of chartered accountants and a senior audit clerk in their employ came to a sudden end following what our Australian informant describes as a glorious row. The firm then sued the audit clerk for the recovery of salary paid in advance and one month's salary in lieu of notice, and the audit clerk counterclaimed for three months' salary for wrongful dismissal. The controversy which had led to the termination of relations arose, according to the audit clerk, because of his insistence on clearing up certain discrepancies in a client's 1950 accounts before going ahead with the audit of its 1951 accounts and his principals' equal insistence, still according to the audit clerk, that the 1950 accounts were closed and that he had better mind his own business. In these circumstances the accounts of the client company were of course most important in the litigation which had been launched, but on a demand being made of the firm for production of the relevant documents in their possession the firm objected to producing them on the ground that they were the property of the client. The audit clerk then moved the Court to order production on the ground that the papers belonged to the firm. The Court of Appeal held that an auditor's working papers, draft accounts and tax computations were the property of the auditor and not of his client and had to be produced, but that documents prepared by the firm as agents for the client, in particular correspondence between the accountants and the Inland Revenue in regard to the accounts and the tax computations thereon, belonged to the client and need not be produced. A demand had originally been made for production of the client's private ledgers containing entries for its 1950 and 1951 years but this claim was dropped and, the Court commented, had been properly dropped.

# Advantages of Fund Accounting for Hospitals

By Walter W. B. Dick, B.Com., C.A.

**Fund accounting presents a factual story of a hospital's financial relations which may be interpreted readily by everyone concerned with hospitals**

UNIFORM accounting as advocated by Canadian and American Hospital Associations for use by their member institutions calls for the adoption of fund accounting.

The promotion of this type of accounting is not without purpose, and it is the intention of this article to suggest the benefits of the fund system of recording financial transactions and presentation of financial statements.

## The Development of Fund Accounting in the Hospital

An aim of all accounting is to make available to everyone a factual story of financial relationships which may be interpreted readily. In the case of the hospital "everyone" means the board of trustees, the administrator, the patient and his agent, the giver of charitable gifts, and of increasing importance the taxpayer. For this reason the financial statements and supporting schedules developed should be designed so that everyone may determine to what extent the objects of the activity accounted for are fulfilled.

While today's hospital is entirely different from yesterday's hospital professionally, administratively, and economically, it is still dedicated to the philosophy of charity. The historical beginning of the hospital as a charitable institution is exemplified in the modern hospital by the prevailing principle that no one requiring care will be denied it because of the lack of ability to pay the bill. This principle of free service establishes the grounds for institutional appeals for financial assistance from the public by voluntary contribution and by taxation.

In the not distant past, before the incidence of high income taxation, hospitals sought and were the recipients of many gift dollars. In many instances there were restrictions in the use which might be made of these contributions. This means that donations of money or kind were given over in trust to the hospital to be expended for a particular purpose.

The purpose of the trust might limit the use of the principal and/or income of the gift to expenditures for buildings, equipment, or subsidization of the day-to-day operation of the hospital. In the absence of evidence to the contrary, it may be assumed that the fund ac-

counting currently in use in hospitals was developed to account for voluntary gifts or tax grants in trust.

Over the years certain legal principles have evolved, which insist upon more than ordinary care in the handling of trust assets. Hence, there is need for the type of accounting which most appropriately typifies this kind of stewardship. Fund accounting is most suitable for this purpose.

It is of interest to note that fund accounting is used extensively in trust companies, educational institutions, insurance companies, and governments. Here, as in the hospital, resources are acquired for the most part for a specified purpose, and the related financial reports should reveal the extent to which the purpose is carried out.

### The Mechanics of Fund Accounting

The Canadian Hospital Accounting Manual, and for that matter all published texts on the same subject, assume the reader is thoroughly familiar with double entry bookkeeping techniques. For this reason these treatises on hospital accounting carry little or no description of the mechanics of the fund method of recording and reporting financial transactions.

Furthermore, fund accounting is not found in commercial enterprise (developing, processing, manufacturing, and trading.) Since most accountants are educated for the work in this latter field, they are not familiar with the principles of fund accounting. They often tend to develop certain apprehensions which result in the current common thought that the *modus operandi* of fund accounting is profoundly involved.

In truth, it isn't.

The word "fund" originated in the french noun "fond" meaning foundation. Strangely enough, we shall see that the word "fund" preceding the term accounting is aptly applied. The debit and credit principle involved in recording a financial transaction is the foundation of double entry bookkeeping and is, in fact, basic to the fund procedures giving rise to this discourse. The simplest fund consists of a single financial transaction with the double entry phases, a debit and a credit. For obvious reasons the debit value is of the same value as the credit. This in bookkeeping terminology produces a balanced set of figures. Undoubtedly, this single isolated transaction occurred for a particular purpose.

Thus we can say that the characteristics of a *fund* are that it is an accounting device consisting of related debits and credits maintained in balance and arranged in association in accordance with a purpose.

Because of a number and variety of financial transactions which take place in an organized activity, fund accounting does not retain the simplicity suggested here.

In recording and reporting for values pertaining to a particular project, the need for segregated debits and credits in balance calls for a real understanding of the implications of each financial transaction. In other words, the accountant must visualize mentally the relationship and effect of each and every economic transaction consummated. Today, most organized enterprises consist of several definable functions. Naturally each function area requires the use of certain of the enterprise's resources. It is the task of the accountant to maintain this functionalized arrangement by keeping the debits and credits in each area in balance, so as to be able to prepare a balance sheet and an operating statement for each function. Under these circumstances, each function becomes an accounting entity comparable with an incorporated body (company). Every accountant knows that when there is a fin-

ancial transaction between two incorporated companies, a complete double entry is made in each company's records. The same bookkeeping should be effected when there is a transaction involving two function areas within one organized enterprise. We can say then that within the one enterprise there is a double double entry for a transaction between two function areas. This situation can perhaps best be illustrated by example. Suppose Function Area "A" made a loan of $100 to Function Area "B" in the incorporated company XYZ, then the following entries would be appropriate:

1. In Function Area "A" records
   Debit — Due from Function Area "B" ....$100
   Credit—Function Area "A" Bank Account .... $100
   To record advance to Function Area "B"
2. In Function Area "B" records
   Debit—Function Area "B" Bank Account .....$100
   Credit—Due to Function Area "A" ..... $100
   To record advance received from Function Area "A".

The above journal entries suggest the relationship between the two accounting funds is maintained by means of "due to" and "due from" accounts. In suggesting the preparation of a balance sheet and an operating statement for each function area it is intimated there might be increments in the resources in a fund, and it follows too there will be diminution in available resources. In commercial terminology there is a profit or loss and in non-profit institutions, like hospitals, a surplus or deficit, as a result of the measured movement of the resources in each fund. The net worth of the fund is the difference between the assets and liabilities and is perhaps best related by means of an equity account. Using the double entry equation, we can say assets equal liabilities plus equity (A=L+E).

**Mr. Walter W. B. Dick, B.Com., C.A. graduated in Commerce from Queen's University and attended the Graduate School of Business of Columbia University. He is now a partner in the Moncton firm of Hudson, McMackin & Co., Chartered Accountants, and holds memberships in the N.B., N.S., and P.E.I. Institutes.**

As is evident, we are using E in place of the P found in the bookkeeping formula A=L+P which is included in the opening chapter of most elementary accounting texts.

Experience suggests the great need for accountants to recognize the requirement of the double double entry when a financial transaction occurs between funds within an organized entity. Perhaps if the accountant who is addicted to gum chewing would associate the entry with double double mint, the difficulties with this type of bookkeeping entry would disappear!

## Fund Accounting Applied in the Hospital

In our preceding remarks we stated that hospitals have obtained gifts and grants for certain purposes, all of course associated with providing care for the sick and injured. Furthermore, for reasons of policy and administration the hospital segregates its economic resources into two main divisions:

*First*:—those pertaining to the fixed assets—land, buildings and equipment.

*Second*:—those required to support the day-to-day operation of the hospitals — patient's accounts receivable, inventories, and the like.

For convenience of communication, we place the items in the first division in an accounting entity designated as plant

fund. The direction of the resources of this fund is usually in the hands of the board of trustees of the hospital. This is so because the board of trustees obtains the gifts, grants, and borrowings and so has a real and direct responsibility. The items in the second division are grouped in an accounting entity referred to as a revenue fund. Sometimes it is appropriately enough referred to as current fund or working capital fund. The reason for the latter terminology is apparent since the resources in this category are used to satisfy current operating needs and to provide the capital necessary to carry patient accounts receivable and inventories of supplies. It may be noted that the hospital administrator is usually held responsible for the handling of the items in the revenue fund.

The hospital may have sums of money or property received as a donation in trust for certain specified purposes, or the board itself may have placed restriction upon the use of such gifts. To account for these items there are endowment funds. Here, the need for appropriate stewardship accounting is a must, to be able to comply in all respects, morally and legally, with the trust involved. Within the general group of endowment funds there may be several individual funds each tagged descriptively with the originating and dedicated purpose.

For convenience in accounting there may be other funds such as:

(a) *Sinking Fund* — Accountants are perhaps more familiar with this grouping of accounts. Such a fund is maintained to account separately for appropriations of cash made in keeping with a trust indenture connected with the outstanding bonds of the hospital.

(b) *Temporary Fund* — These are resources set aside temporarily for a specific purpose. At the proper time in keeping with the purpose the fund will be expended. Sometimes resources are set aside in anticipation of a new building and are described as "New Building Fund".

(c) *Convent Account Fund*—In hospitals owned and operated by religious orders it may be convenient to segregate certain resources not directly associated with providing hospital care. In this connection sisters' salaries may be transferred to this account by the appropriate entries. It follows that expenditure not directly related to hospital care will be accounted for in this fund. The above are the common funds found in hospital accounting.

The main thing to observe is that fund accounting is used because there is the managerial need to separate resources devoted to a particular and specific purpose.

The mechanics of fund accounting in the hospital are illustrated by the following entries:

### 1. Supposition

A purchase of securities for the endowment fund is made through the revenue fund bank account in the amount of $10,000. This is followed by reimbursement from the endowment fund bank account. The applicable entries are:

(a) Purchase

(1) *Revenue Fund entry*

| | | |
|---|---|---|
| *Debit* — Due from endowment fund | $10,000 | |
| *Credit* — Bank (revenue account) | | $10,000 |

To record advance for purchase of securities for the amount of endowment (to be reimbursed).

(2) *Endowment Fund Entry*

| | | |
|---|---|---|
| *Debit* — Securities held | $10,000 | |
| *Credit* — Due to revenue fund | | $10,000 |

To record securities purchased by revenue fund (advance to be reimbursed).

(b) Reimbursement

(1) *Revenue Fund Entry*

*Debit* — Bank (revenue account) $10,000

*Credit* — Due from endowment fund .. $10,000

To record recovery of amount advanced to endowment fund and deposited in bank.

(2) *Endowment Fund Entry*

*Debit* — Due to revenue fund ..... $10,000

*Credit* — Bank (endowment account) $10,000

To record reimbursement to revenue fund for advance for purchase of securities.

2. Supposition

A hospital is in the fortunate position that depreciation is included in expenditure and the cash in the amount of the depreciation charged in the revenue fund operations is accumulated and is, so to speak, "free". Furthermore, it is the policy of the hospital to transfer such "free" cash to the plant fund where it may be used to purchase replacements or pay off the indebtedness in that fund. The depreciation charged is assumed to be that in the following entries:

(a) Revenue Fund

(1) *Debit*—Depreciation allowance — Buildings and equipment ..... $65,000

*Credit* — Due to plant fund — depreciation $65,000

To record depreciation allowance for period charged to operations and due to plant fund.

(2) *Debit* — Due to plant fund — depreciation $65,000

*Credit* — Bank (revenue account) .... $65,000

To record transfer of cash being amount of the allowance for depreciation charged in the fiscal period.

(b) Plant Fund

(1) *Debit* — Due from revenue fund ..... $65,000

*Credit*—Accumulated depreciation ..... $65,000

To record fiscal period allowance for depreciation provided in revenue fund expenditure.

(2) *Debit* — Bank (plant fund) ..... $65,000

*Credit* — Due from revenue fund ..... $65,000

To record deposit of fiscal period depreciation allowance provided in revenue fund.

The carrying out of transactions for depreciation, suggested in supposition 2 above, is generally referred to as "funding the depreciation allowance". This is considered to be a sound financial practice. Unfortunately, more often than not, because of operating deficits in revenue fund and the need for further resources to support patients' accounts receivable, inventories, and the like, it is not possible for a transfer of cash to be made from revenue fund to plant fund. In practice revenue fund will owe plant fund for the depreciation allowance, less any disbursements out of revenue fund made for the account of plant fund for the purchase of fixed assets and payments to creditors of the latter both short and long term.

The entries illustrated above are all that are required to keep a balanced relationship between the various funds maintained in the hospital. The "due to" and "due from" accounts, like the equity account (fund capital account) should be susceptible of an analysis to reveal the details of any transaction carried through these accounts.

## Advantages of Fund Accounting for the Hospital

While the hospital of a few years ago might not have needed appropriate accounting to tell its financial story, the hospital as it is today cannot afford to ignore the potentialities of uniform accounting and this means fund accounting.

The hospital as a non-profit institution

with the motivating ideal of never refusing care must tell its dollar story so the great bulk of the people using hospital services may be assured that the payments for care are equitably made.

In this latter connection third-party paying agencies, the voluntary prepayment plans such as Blue Cross, charitable organizations, and various governments must know that patient billings are reasonable. The only way these agencies can properly and adequately appraise the economic situation is by interpreting and evaluating the financial statements of the hospital.

Because of this mixture of service on both a business and charity basis there is great need for the type of financial information available in fund accounting. Suppose all gifts received for charitable purposes by a hospital were maintained in a separate fund and, furthermore, that there was one established rate for each type of service. Assume, too, that all charity bills would be paid to the hospital out of the charity fund. It is apparent how such an approach would eliminate the need for private patients or X-ray patients to subsidize charity service. It is human nature to be charitable yet there are those who suspect the hospital of using charitable gifts to look after patients who can afford and in many cases would willingly pay the full cost of their own care. The advantages of fund accounting in promoting a sound policy toward charity are clear.

In addition, where the hospital seeks and receives restricted gifts and grants there is the moral and legal duty to record and report as to their disposition. As pointed out, fund accounting is essential in looking after this type of obligation.

In administering the resources of the hospital and differentiating between the interests of the trustees and the administrator, fund accounting permits the paper segregation between fixed assets associated with the former and the day-to-day operating resources which are the concern of the latter.

Fund accounting if carried out completely in the hospital points up sharply a current weakness in hospital financing, namely the neglect in not providing adequate resources in the revenue fund. It seems that it is much easier to solicit donations for the plant fund because the asset to be acquired can be identified. By developing and presenting financial statements in funded fashion the hospital accountant can depict clearly this unfavourable revenue fund situation for the comprehension of trustee, administrator, and all others interested in the finances of the hospital.

In all, fund accounting gives the hospital a means of presenting and interpreting the various phases of its business activities to interested outsiders. Finally, and by no means the least important, management is provided with an administrative control tool much needed in an institution of the complexity of the modern hospital.

## CHANGES IN THE CANADIAN TAX FOUNDATION

The Governors of the Canadian Tax Foundation announce the appointment of Mr J. Harvey Perry as chief executive officer of the Foundation, effective April 1. He succeeds Mr Monteath Douglas who resigned in order to accept a position with the National Industrial Conference Board as director of their new Canadian division. Mr Perry had been the Foundation's director of research since 1952.

# Uniformity In Terminology

By Montagu Clements, C.A., A.C.I.S.

**The need for uniformity in written expression has always been recognized by professional men**

WEBSTER'S International English Dictionary (1947) tells us that our language contains some 550,000 words and that a number of these have more than one meaning. As in any other language, new words continue to sprout; at the same time some branch into different directions and others fall into disuse.

Under these conditions can we hope to obtain any degree of uniformity in either our speech or our written expression?

### The Language of the Angli

Some 1,500 years ago, Teutonic peoples from Europe crossed over the North Sea into Britain. They had done so before, but this time there were no Roman legions to resist their invasion, and they came to stay.

One of these tribes was called the Angli; it ultimately gave its name to England and to the language of the English-speaking world of today.

Influenced and extended by Latin scholars in the Church (and, later, by the Norman-French tongue of the followers of William the Conqueror) the Teutonic language of the invaders developed by uneasy stages from what we now call Old English into Middle English. During the last half of the 14th century Chaucer gave the country a wealth of literature studded with words from the Romance tongues of southern Europe. When, about 100 years later, this and other English literature had been woven into the language pattern of the realm by the introduction of the printing press, the foundation for Modern English had been laid.

The writers of the past four centuries, ably led by the Elizabethan authors, have so enriched and multiplied the words of the language that in 1947 Webster's New International Dictionary was able to produce definitions for more than 500,000 English words.

And it is still called the language of the Angli.

### Old English

In the early stages of language development the Angles (or Angli) dominated for a time that part of the country between the Firth of Forth and the Thames River; this was occupied by Northumbrians and Mercians, sometimes called the Anglian group. It was here that English literature was first produced, and this may have been the rea-

son why "Englisc" ultimately became the name for the entire group of dialects used by the invaders — who had now become settlers. (It included the dialects of the southern group: the Wessex and Kentish peoples south of the Thames). During this and later periods the country was never under the undisputed domination of its Anglo-Saxon, Danish, or Norman monarchs. During King Stephen's reign, for example, there was anarchy rather than monarchy, and by the middle of the 12th century each of the barons ruled supreme in that territory which lay within the domain of his castle or castles. The language, a heterogeneous mixture of dialects sprinkled with Norman-French, was at this period changing into Middle English.

### Middle English

The influence of Norman-French, which at one time had threatened to replace English as the language of the country, went into a decline soon after the alleged reign of Stephen. By 1362 English had re-established itself and was introduced into the courts of law. As previously indicated, Middle English reached its peak at the time of Chaucer, after which the literature of the country made little progress until the Elizabethan writers appeared on the scene. It was they who were responsible for our Modern English.

### Modern English

The language of the English people was not uniform during the reign of Elizabeth I. Many of them had never learned some of the Latinized words introduced by the clergy and the Normans, and when there was not a Teutonic word available in which to express their ideas they frequently compounded one. But the upper classes often refused to adopt the Teutonic equivalents; for instance, they preferred to say "impenetrability" rather than "ungothroughsomeness". It therefore was considered necessary, when compiling an English prayer book to be used by all classes, to write some of the words in both speeches in order to ensure a proper understanding by all the people. Hence we got "pray and beseech", "assemble and meet together", "acknowledge and confess", — and other instances of tautology.

This brief summary of the history and development of the English language will serve to demonstrate that the accepted tongue of a country does not grow from a dictionary; the dictionary is merely the lexicographer's conception of the current state of the language of his country.

### Ambiguous Terminology

The achievement of complete uniformity in a living language is rendered difficult and even impossible by constant changes in pronunciation, in spelling, and in the meanings attached to words and phrases. Educators and legislators can do little or nothing towards keeping the situation under control. A new word is given to an old concept and established words take on additional meanings. As the old words and definitions also continue to function it becomes increasingly possible to attach two or more meanings to the same expression or sentence.

Here is a simple example of what may happen: the Latin word "ex", meaning "out of", joined to "sequi", meaning "follow", becomes "execute". An *executor* is one who follows up, or carries out, the action called for by an order or, possibly, by the impulse of an artistic conception. When the subsequent action heads off in different directions the same word may take on different shades of meaning. For example, in addition to meaning "a head chopped off", *execution* may imply "dexterity in

performing music". Thus, when Maggie, at the conclusion of the *prima donna's* aria, asks her uneducated husband, "What do you think of her execution?", Jiggs, mistaking the general drift of her question, cheerfully replies: "Oh, I'm in favour of it."

### American Innovations

During the past 200 years or so the Americans (by that I mean the people of the U.S.A.) have made valuable additions to and improvements in the English language. Their contributions have also increased the lack of uniformity in the interpretation of words and phrases. Sometimes they may go so far as to cut a word from its original root and graft it on to another, as they have done with "caption". Canadians have a tendency to follow the American lead in their treatment of the English language. There are cases, however, where they stay with the old tradition: the Government of Canada still has its Department of Labour although many Canadians use the American form "labor" and a few of them will even write "check" when they mean "cheque".

It should be explained here that our subject is restricted to the written word only; it is still an open question as to whether uniformity in the spoken word is desirable, even if such were possible. The perpetual arguments about pronunciation are usually merely a clash of illogical opinions leading to the general conclusion that tastes among educated people often vary and cannot always be reconciled.

The need for uniformity in written expression has always been recognized by professional men, and the vocabulary of a living language, with its constant tendencies towards growth and change, requires frequent revision. Some time ago the Canadian Institute of Chartered Accountants — then called the D.A.C.A. — decided that this situation was important enough to warrant the appointment of a special committee on accounting terminology. During a brief talk the chairman of this committee told me about his difficulties with American innovations. He mentioned the use of "caption" to indicate "heading" or "title". (Caption is derived from "captio" — not from "caput". The former means a "legal arrest"; the latter a "head"). I brought my own pet aversion into the conversation, the word "analysis" (and sometimes "schedule") which had recently been more or less supplanted by "breakdown". "A breakdown of investments" (quoted from a recent report) does not imply, as the Concise Oxford Dictionary might have you believe, that the investments in question have suffered from a collapse or stoppage, or a failure of health and power. The auditor is simply referring to a supporting schedule attached to his report.

There have been many instances where a new meaning has overshadowed the original. We all know that "dumb" means unable to speak, but how many of us nowadays use the word to indi-

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cate something which is rather the reverse — more like "given to too much inane speech"? (The German Americans may be responsible — "Dum" means "stupid" in German. But similar things can happen in English: an "innocent" of Shakespeare's vocabulary has become an "idiot" in the language of today.)

The confusion arising from the adoption of new and different meanings for the same word was illustrated in a recent incident in Regina. A local barrister was having difficulties with the word "sheriff" as it appeared in a document of Scottish origin until a colleague trained in Scotland explained that a sheriff in *his* native country was a judge — not merely an officer of the court as in Canada and elsewhere. (A sheriff in Canada would be described in Scotland as a sheriff's officer, i.e., an officer of the sheriff's court.)

### An Auxiliary Language

I have endeavoured to explain that the growth of a living language is, in many cases, governed by the whims and fancies of the people. It often leads to changes in spellings, pronunciations, and in the meanings applied to many of the words. Efforts are constantly being made by the C.I.C.A. and others to clarify the language of business by setting up rules which would allow only one definite interpretation for certain words and phrases. This useful work could be extended to provide other words to fit the alternate definitions at present in use. If the word "billion", for instance, which is now used by many to mean "one thousand millions", reverted to its original meaning (by which it is still known in Britain and Germany), a new word for "one thousand millions" might be provided. As Canada has a bilingual Province the French word "milliard" meaning "one thousand millions" might supply the need.

*Vice versa,* the proposed dictionary would take care of those cases where two or more concepts are crowded into the same word. In the French edition of a Canadian Hospital Manual, published a short time ago, (i) income, (ii) revenue, and (iii) cash receipts were all translated by the same French word "recettes". This may suggest one reason why some of the French accountants prefer to use the English copy.

An auxiliary synthetic language adopted by a universally approved international court would be an ideal solution to many of our problems. But at the present time such can only be regarded as a desirable prospect for the remote future. Although Esperanto has made much progress, especially in Europe, since it was first introduced by a Russian in 1887, it is far from being generally understood by the English-speaking world of today. Since there is an urgent need to reduce the confusion resulting from the complexity and ambiguity existing in present-day English, it would seem advisable to establish acceptable definitions as the need arises and build up a vocabulary in cooperation with other professional bodies. In order to ensure that the proposed definitions will be acceptable to the public, they should be ratified by law.

There is no suggestion here that our living language be replaced by a synthetic one. The English-speaking world will not of course surrender its heritage of literature built up through 15 centuries from dialects brought to the country by tribes of barbarians who, in a spirit of joyous adventure, or possibly animated by an uncontrollable desire for *lebensraum,* left the banks of the Elbe River in Germany and the Scandinavian countries of northern Europe and, after pushing the Celtic inhabitants to the north and west, set up an Angle land on the Island of Britain.

# The Interpretation Of Taxing Statutes

By Francis Lorenzen, B.Com., C.A.

**It may be the Tax Department which carries the responsibility for inequities in our tax system**

IN the May 1951 issue of *The Canadian Chartered Accountant* two excellent articles appeared by Mr. Edwin N. Griswold, Dean of the Harvard Law School, and by Mr. Stuart Thom, barrister of the city of Toronto. In the October, 1953 issue of *The Tax Review* an excellent article from the pen of its always lucid editor appears. Throughout the former two articles the inference is large that it is the taxpayer who is invariably trying to take advantage of a strict interpretation of the Act and the tax authorities who are struggling to collect a fair tax. Mr. Thom quotes from a statement by Lord Simon in *Latilla* v. *Inland Revenue Commissioners*:

> There is of course no doubt that they, the taxpayers, are within their legal rights but that is no reason why their efforts or those of the professional gentlemen who assist them in the matters should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one result of such methods, if they succeed, is, of course, to increase *pro tanto* the load of tax on the shoulders of the great body of good citizens who do not desire or do not know how to adopt these manoeuvres.

A review of the reported cases on the Income Tax Act suggests, however, that in a very large percentage of cases the Government places interpretations on the provisions of the Act which are both inequitable and diametrically opposed to ordinary legitimate business practice. You then have the sad spectacle of the Courts solemnly deciding "Parliament's intention" by applying their understanding of what is a strict interpretation of an involved section of the Act. From the reasoning which is invoked it is very obvious that few, if any, of the Members of Parliament sitting at the time the section was enacted could have grasped the precise meaning (assuming they had read them) of the words chosen by the draftsman responsible for putting "Parliament's intention" into language.

*For example*:

**The Case of the Travelling Carpenter**

In *Hunter* v. *MNR* (August 1949) a carpenter being unable to earn enough income to support his family in one town increased his income by travelling to another town where he had obtained additional employment, and claimed to deduct $300 for "meals and lodging while away from home in pursuit of a trade or business". The Board held that the

expenses were personal and living expenses. No doubt the Board was correct in its strict interpretation of the word "business", and the expenses were not "travelling expenses" within the narrow meaning given to that section, but were they not, however, in the main necessarily laid out for the earning of the carpenter's inccome? The carpenter could not have earned the additional income if he had remained in his home town and he certainly didn't travel for his health.

When anyone in business practice contemplates the millions of dollars of "personal and living expenses" paid by companies for employees and their families moved from one place of business to another and maintained there while awaiting proper housing accommodation, all of which expense is charged to company travelling expenses, a serious question arises as to the equity of the decision in the carpenter's case. If the unfortunate carpenter had had the advice of a "professional gentleman", he could have arranged with his employers in the second town to pay for his transportation and lodging and reduce his remuneration accordingly.

### Tax-Evasive Transfers

In dealing with section 21(1) of the Act governing transfers between husbands and wives formerly under a sectional heading "Transfers to Evade Tax" the Courts have held, contrary to the belief of probably 99½% of all tax consultants prior to the *Dorothy Goodman* case that the heading had no bearing on the subject of the section and that the word "transfer" covers all methods of transferring property, including bona fide sales for value. This decision has upset established business practice with endless complaints resulting. If the Administration and the Courts were correct in this "strict interpretation", are the majority of taxpayers completing the "Gift Tax" section of a T.1 guilty of making false returns? It contains the question, "Did you transfer any properties, securities or cash of a value in excess of $1,000 to any person in 19—?" If you answered that question in the negative, even though it appears under the heading "Gift Tax", and in that year you so much as purchased a car, have you not made a false return?

### The Case of the Indiscreet Partners

In *Klamzusky* v. *M.N.R.* we have the Minister of National Revenue declining to amend an assessment even in the face of the Judge's highly critical remarks as to the exercise of the Minister's discretion in denying the wife the right to participate in the profits of a partnership between herself and her husband when from the facts presented, the partnership was bona fide and the allocation equitable.

### Farmers' Right to Average Income

In the series of cases arising from the Administration's attitude on the proper interpretation of section 39(1), we have the Courts placed in the humorous position (one lone dissenter) of deciding that "Parliament's intention" was that if a farmer did not file all of his tax returns in the averaged period *on time*, he was not entitled to average. I doubt very much if anyone, knowing Parliaments' attitude towards farmers, would seriously contend that that was Parliament's intention. Can you imagine Parliament passing on that section if the Minister of Finance, or someone for him, had said at the time, "This section means that any farmer who has failed by inadvertence to file one of the returns of the five averaged years on time, being late by so much as one day, may lose thousands of dollars of tax refund, while at the same time remaining subject to the normal penalties for late filing, which Parliament has previously decided were fair punishment for the offence"?

### The Case of the Unfortunate News Vendor

The case of the Unfortunate News Vendor (*Collins* v. *M.N.R.*) saw the Courts confirming the Administration's disallowance of a newsdealer's provision for the liability to accept returns of unsold magazines. The Courts held that the two contracts involved in that case were not conditional on each other but were independent. Would any businessman or member of Parliament seriously contend that a retailer would have signed a contract to purchase magazines unless the distributor bound himself by contract to take back those which could not be sold?

We have an endless variety of cases brought at the insistence of the Administration where the Courts have held that expenses were not properly deducted from earned income. The word "income" is not defined but is usually held by the Courts in such cases to mean gross income, e.g. fees rendered, gross commissions received, sales, etc., rather than net income. An expenditure which reduces expenses is as important to a businessman as an expenditure which promotes sales, but the Courts have held the former non-deductible. Expenditures are made over a period of years for the promotion of business which may not culminate in the promotion of any special sale at all or promote sales in years to come. These expenditures the Courts, prompted by the Administration who have first to make the assessment, repeatedly disallow on the ground that they are "antecedent to the earning of the income". It is true, is it not, that advertising expenses must be "antecedent to the earning of the income", but in no case have I ever known the Administration to disallow such an expense, yet if entertainment and business promotion expense is not deductible under the Act for that reason, does not consistency require that all advertising expense be disallowed also? Similarly with accounting and auditing fees. Rarely are these expended to earn income, since they deal with income already earned. Do the foregoing Court decisions not then require them to be classed as capital expenditures incurred to ascertain and protect income after it has been earned, and thus non-deductible?

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### The Case of the Kindly Insurance Agent

An insurance agent (Scales) gratuitously paid premiums on behalf of his customers. The Minister of National Revenue contended and the Board held that *it was not necessary for him to do so,* and that the direct effect would be limited to improving his goodwill (a capital asset) and make future earnings possible, and that the payment was therefore purely voluntary. The Board did not say what its decision would have been had the payment been made pursuant to contract, but the stress on the "voluntary" parallels the Administration's contention that a provision for redemption of milk tickets is prohibited because it is "voluntary". In modern business practice a great many expenditures are made solely for goodwill which, unless you are the happy possessor of an unshakable patent, is the lifeblood of earnings.

If expenditures are to be disallowed because there is no legal obligation to incur them, have we not come to a point where drastic action is required? There is, for example, no reason why I should use electricity for lighting my office; I *could* use a candle. It is simply

that, in the business judgment of a taxpayer, an expenditure for electric lighting is necessary, and of course I am stuck with my own business acumen. If I haven't any, I won't have to worry about taxes!

### Interest Non-Deductible

In the *McCool* case interest on the unpaid balance of the purchase price of the property was disallowed as "not being interest on borrowed capital". The Administration and the Courts, in dealing with the word "capital" seem to have some difficulty in distinguishing between capital assets and the liability arising from funds borrowed for their purchase. But even if the money expended was not interest on borrowed capital, was it not nonetheless a current expenditure necessarily and wholly laid out in the earning of the income? Would it have been possible for the taxpayer to have earned any income without the "borrowing" of the property (capital) in question? Would it have been possible for him to have acquired the property if he had had to pay cash for it? Did the expenditure confer a lasting benefit? In short, was the expenditure not a legitimate and justifiable deduction from the gross income of the taxpayer whether it was interest on borrowed capital or of some other nature? Would it not have been allowed if the taxpayer had taken the precaution to cross cheques with the debtor?

### The Controlling Shareholder

Consider the purchase of property by a corporation from a shareholder holding one share of stock only. A transaction of that description was held by the ITAB to be "not at arms length" on the ground that a shareholder is "one of several persons by whom the corporation is . . . controlled". While that decision may well be an improper interpretation of the statute, at the same time it is not the Courts who originate cases. Cases arise because some taxpayer feels that he is unfairly or improperly taxed and *is able to do something about it.* Is the Tax Administration not aware that the words "one of several persons by whom a corporation is controlled" have a meaning to businessmen which is quite different from that of the ITAB in the decisions mentioned? The Ontario Securities Act contains words of similar import and, so far as I know, no holder of one share of stock has been prosecuted by the Commission for a false prospectus when answering the question dealing with that section in the negative. It would have been quite simple for Parliament, had it been intended that all shareholders were to be considered as members of a group controlling their corporation, to have used the word "shareholder" instead of the much more cumbersome phrase actually adopted.

### Musicians' Expenses

Why the Department has permitted innumerable cases involving the expenses of professional musicians to go before the Board is beyond my understanding. Surely this is a burden unnecessarily placed on the very able but over-worked members of the Board which could have been handled fairly by compromise settlements, without so much expense both to the taxpayer and the Government. If the Administration feels that the law should be clarified why could it not have withheld the assessments and proceeded with a test case to the Supreme Court? Why should so many taxpayers be subjected to heavy appeal expense because the Administration had been unable to draft a section of the Act which fairly and clearly subjects net income to tax in accordance with standard business practice?

### Changed Policy in U.S.A.

During the recent Tax Foundation conference in Winnipeg, Mr. T. Coleman Andrews, Commissioner of Internal Revenue, was speaking about his Department's recent crack-down on business entertainment expenses, stating that they planned to cast a very critical eye on expenses of wives attending conventions with their husbands. Following a recent speech in which he had stressed this point, he related that his assistant had come to him somewhat perturbed, stating that he felt his boss had made an error seriously affecting the mores of the business community. On being asked to explain himself the assistant replied, "Formerly when a businessman attended a convention he took his secretary, introducing her as his wife; now when he takes his wife he is being forced to introduce her as his secretary."

Of much greater importance, however, were the Commissioner's remarks as to his findings with respect to a study of the Tax Court cases in the United States, and one wondered at the reaction of our Deputy Ministers of Finance and Revenue who were present. Mr. Andrews stated that he had found that his Appeal Section was losing from 50% to 60% of the cases coming before the Tax Courts, which meant in his opinion that the Administration was trying to collect tax improperly in a very large number of cases. He has, accordingly, issued instructions reaching down to the most junior assessor that, while the assessors are to be increasingly strict as to the inclusion of all amounts which should properly be included and the disallowance of all expenses and exemptions improperly claimed, they are to be equally zealous in apprising the taxpayer of any manner in which his net reported income might properly be reduced. He concluded by stating that he had advised his Appeal Section that he expected they would be able to increase the percentage of winning cases to a minimum of 90% by settling out of Court those of doubtful legitimacy, and at the same time very materially improve the relations of the Administration with the taxpayers.

Anyone with an extensive tax practice knows how great is the gap between this viewpoint and the past practices in both countries. Many people are said to dream about winning an Irish Sweepstake ticket or finding oil in their backyard. The dream recurring most frequently to a tax accountant is one where he is remunerated by a commission by taxpayers of 10% of all taxes improperly paid by them in his tax district alone; and a commission of 10% by the Government on all tax which should have been paid by those improperly reporting their income!

### Not Only Income Tax

Although I have so far dealt solely with the Income Tax Act, the same problem confronts the Government and the taxpayers with the other taxing statutes, the various sales and excise taxes, customs and succession duties, etc. and the question naturally arises how does such a situation come about, and is there anything that can be done about it? The situation has arisen and has been allowed to develop over the years through the natural reluctance of taxpayers to pay taxes on the one hand and the tremendous need of the Government for revenue on the other hand. Governments have found that in order to prevent tax avoidance they must be very careful in drawing the taxing statutes as the Courts have consistently found against the Government where the taxpayer could not clearly be brought within the precise meaning of a section of the statute.

### Close the Gaps

These taxing statutes, the Income Tax Act for example, are the culmination of

a long series of attempts to evolve a perfect Act, one which, based on countless Court decisions over many decades, is devoid of pitfalls. An Act of Parliament, or an amendment to an Act, originates in broad outline in the minds of the leaders of the Government. If it deals with technical matters rather than rates, exemptions, etc., the changes are suggested by the officials of the Department of National Revenue actively engaged in its administration. Amendments are then drafted in more specific language by members of the Departments of Finance and Revenue, having in mind the needs of the Department of Revenue and the experience of its members. This outline is then sent to the skilled draftsmen of the Department of Justice. The Act or amendment is then adopted by both Houses of Parliament usually with little or no debate. Once changes have been enacted it is up to the run-of-the-mill taxpayer and the tax assessors at the lowest levels to interpret what is a very complicated document indeed. The average taxpayer has as his guide a tax return, while the assessor has in summary form an interpretation of the Act drawn up by officials of the Department of National Revenue at Ottawa, called the "Black Book".

There are thus two tremendous gaps existing in the tax machinery. In the first place very few members of Parliament are qualified to know what the words coming back to them via the Departments of National Revenue, Finance, and Justice really mean. On the other hand, at the other end of the chain sit the taxpayer and the tax assessor, the former almost completely ignorant of the subject, guided solely by the questions on the tax return and the answers of local assessors, if the taxpayer has the wit to ask the proper questions and if the local assessor has the experience, knowledge, and goodwill necessary to advise him properly. I think most people will admit that these gaps are very wide indeed when, on a very large number of the subjects covered, experienced tax lawyers and accountants have such widely divergent views.

And if that isn't enough to explain why so many difficulties occur, we have the basic split in administration arising from the divided responsibilities of the Departments of Finance and Revenue. We have had the sorry experience of reading that the Minister of Finance denies responsibility for certain practices of the collector on the grounds that his Department just writes the law, and the Minister of National Revenue shrugging the complaint aside since, as he says, his Department only administers the Act as written.

There are so many major and minor conflicts where equity and public policy are not the guide that to select those which best illustrate the types of difficulties is a very great task.

### Misleading Forms

Dealing with the forms, we have, for example, the case of a doctor who, having taken advantage of the premium being paid for cars in 1949, sold his car for more than he had paid for it in 1947. Being more than ordinarily skilled in tax matters he asked the district tax office in the spring of 1950 the meaning of the words "Proceeds from disposals" in the capital cost allowance section on the fourth page of the T.1. Any layman would be justified in believing that the phrase meant "the selling price of the car", and this in fact was what he was told by the tax office who subsequently repeated the same view to his accountant. This despite the clear wording of the Act that only the proceeds of sale *not exceeding the undepreciated capital cost at the 1st of January 1949* are subject to recapture. On instructions from his head office the local chief assessor later stated that he had

not understood the question correctly. How many taxpayers have there been who, not knowing of these complexities, have overpaid tax as a result of that misleading item on the tax return?

### Those "Reserves" Cases

We have the whole series of cases covering the disallowance of "reserves" for tickets, etc. coming as a bombshell to the business community and resulting in the drastic and probably ill-advised revision of the Act. All this hysteria and confusion seems needless and the decisions not in accordance with what the Act surely must have intended. If the Administration felt that the language of the Act made it imperative that they disallow these "reserves", then, before any assessments were made, they should have in all equity changed the Act. However, this would seem to be unnecessary as, unless the taxpayer was in the first year of operation, the refusal of the Minister to allow the "reserves" at the end of the year might well have had no effect on the income for the year, since he would, likewise, have to exclude the "reserve" at the beginning of the year from his calculations. Moreover, is he not barred from changing the method of computing income adopted by the taxpayer, with his approval, in prior years, by virtue of section 14(1) of the Act? It is only with new businesses where there was any occasion for alarm if "reserves" were disallowed, and in all equity if the Minister was satisfied that the Act did not permit their allowance then surely the proper amendment should be made prior to the assessments of any such taxpayers. In the alternative, the Act should be amended retroactively and the assessments voluntarily reopened by the Minister.

### Administration Lacks Business Experience

While the routine of the drafting of Acts and amendments to Acts may thus be a major cause of the difficulties, it is by no means the only one. Of probably somewhat greater importance is the composition of the staffs of the three Departments concerned and particularly of those men dealing with the drafting of the legislation and its interpretation. In accordance with my experience and competent outside advice, it seems to me that in the main the people responsible for drafting the legislation and its interpretation have had little or no *business* experience in the application of these Acts. They are either senior officials who have spent their entire working lives in the Departments engaged in such work, or they are theoretically well-qualified individuals who have entered the Department directly after being admitted to the Bar or receiving their degrees in chartered accountancy, etc. This situation can, and should be, corrected.

In addition, it seems obvious that the narrow legal aspects of the statutes assume too high a degree of importance and that there would appear to be a substantial lack of experienced accounting knowledge available to the lawyers for the Department of National Revenue, to the Appeal Board and Tax Court judges. Some of the decisions reached, for instance those involving the disallowance of tickets' reserves referred to above, are quite incomprehensible to a tax accountant. From the statements of the present Commissioner of Internal Revenue of the United States, quoted above, it seems obvious that if he is able to accomplish his expressed purpose, there will be a revolution in the tax administration in the United States. It is interesting to note that according to him he is the first public accountant to hold this position in the United States, his predecessors having been practising lawyers.

### The Remedy?

The suggestion has been made on

many occasions that the ITAB should include among its members businessmen and accountants. While I favour that suggestion as an improvement on the present practice, it is possible that a better plan would be to make available to the members of the Board and the Courts experienced and *independent* tax accountants to whom they could turn to supplement their knowledge. In addition, where the Court finds that the proper interpretation of a section of the Act is manifestly unfair to a taxpayer the Government ought to withhold further assessments, amend the Act, and re-assess where inequitable assessments have been made.

One may also suggest that before new legislation is introduced a panel of tax practitioners should be consulted as to its practical effect.

Why not accept the defence of the Department of National Revenue that they are only tax collectors and let all discretionary authority, the issuing of regulations under the Acts, and the entertaining of objections be transferred to the Department of Finance where the policy and the needs of the country as a whole will be the guiding factor rather than the collection of the maximum revenue?

Although the above is a one-sided argument against the administration of our taxing legislation, I do not suggest that the Judge's comments quoted at the beginning of this article are in any way unfounded. As the opposite side of the coin has been so ably presented, it is hoped that the study of this side might also prove useful.

Surely it is not too much to hope that the Department of National Revenue should some day also be recognized as a department of justice by *all* taxpayers.

# A Letter from a Reader

*Vancouver, February 20, 1954*

EXPLANATION PLEASE

Sir: Re letter from Mr. C. A. Ashley, F.C.A. in the February issue of *The Canadian Chartered Accountant*:

If Mr. Ashley's suggestion is followed, the expression "at the lower of cost or market" would read "at the lower of cost and market". The first term I understand; the second I do not.

Why is the lower of cost or market method "deplorable" as Mr. Ashley states? He should at least explain what he has in mind, for presumably he writes to help and not only for the pleasure of criticizing.

W. G. ROWE, F.C.A.

**Mr. Ashley's Reply**

In reply to Mr. Rowe, all I can say about "at the lower of cost or market" is that this is faulty English, whereas "at the lower of cost and market" is impeccable. This method of valuing an inventory is deplorable because it is inherently inconsistent. If the accounts stated that the inventory was valued at cost one year and at market the next year, no one would accept this as reasonable, but if prices were steady or rising during the first year and falling in the second year, the inventory would have been valued in both years at the lower of cost and market. There is, in fact, an appearance of consistency merely because the same words are used in each year, but it is spurious. I have written to this effect before in *The Canadian Chartered Accountant*, which is the reason why I did not explain in my recent letter why I thought the method deplorable. But I thought a reminder might be worthwhile, as it evidently was.

C. A. ASHLEY, F.C.A.

# Style for Students

By George Simons, C.A.

A plea for official recognition
of the need for better English in the profession

AN audit might be defined as an examination of accounts culminating in a report. Students learn how to conduct the examination during their training period but, judging by the available evidence, few of them can write good reports. It is the report, however, which distils their work, and it is the report which will be read by clients and other interested persons.

The content and form of a report may range from a brief qualifying paragraph in a standard short-form audit certificate to a book describing a new system. Whatever the purpose, the impact of the report will depend largely on its presentation. However fine the auditor's work, however important the facts and his comments, poor presentation will make a report appear dull and even incomprehensible. Clear exposition in well-chosen language, on the other hand, will make every fact and every opinion strike home.

Many public accountants all over the world have come to the conclusion that to the accounting student facility of expression in writing is far more valuable than the "head for figures" which people outside the profession consider so essential. Clear speaking and writing are the direct results of clear thinking; conversely, lucid and logical thought is promoted by the knowledge that ideas must be expressed in a form which is communicable to others. It is therefore unfortunate that the standard of English of a large number of young people today is deplorable, and that students-in-accounts are on the whole no exception.

This situation may be due in part to the educational system with its swing of emphasis from the humanities to science. Probably the press, the radio, and other media of entertainment share responsibility for it. Whatever the cause, it is a fact that people who usually do not converse in grammatically correct language have difficulty expressing themselves on paper. How can anyone concentrating on spelling and grammar produce fluent well-phrased sentences? The accounting student must contend with an additional handicap: he often has to study textbooks and other publications written in an involved and ponderous style which, in the nature of things, he may try to imitate. All these factors help to produce the (otherwise good) accountant who, each time he has trouble expressing himself on paper, writes "with regard to", even though the use of this phrase

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postpones his dilemma by only three words!

What, then, can the profession do to raise its students' standards of English and educate them to write good reports?

There are many ways in which the student can be given the opportunity of improving by practice, though these will vary from one office to another. From the outset a junior clerk could be expected to write audit notes himself, and in the course of the review the senior should point to the importance of clear and concise English. Intermediates should be encouraged to draft letters and reports whenever possible. By the time of the final examination and increased responsibility on assignments, students would thus be equipped not only with theoretical knowledge and its application but also with the ability to express their comments.

The uniform examinations do not, at present, stress the importance of good writing. Marks for style and form are given only for some of the auditing questions, and this is not sufficient inducement to make students treat the writing of English as a fit subject for preparation and practice. Moreover, a candidate racing the clock is naturally more concerned with matter than with manner.

Greater emphasis on composition in the examinations would undoubtedly develop more fluent students and more accomplished chartered accountants. Here are some suggestions:

1. (a) A high standard in English on leaving school or university for those wishing to enter a C.A.'s office, or
   (b) An examination in English for those who cannot meet these requirements.
2. Insistence on adequate manner as well as matter throughout the uniform examinations.
3. At least two questions in the final examination to test the candidate's mode of expression and clarity of thought. (Some questions on these lines are already being set, of course.) It is recommended that one question be in the *precis* category. The other could demand a report on an assignment or the headings and lay-out for such a report. The first type of question would test the candidate's ability to condense information and present it in his own words; his answer to the second would show his aptitude for expressing his own thoughts and setting them out in a logical form.

If some such proposals are adopted and if practitioners will insist on good English in all working papers, there should be a gradual improvement among students and other accountants. " 'Tis a consummation devoutly to be wish'd", for the clearer the voice of its members, the stronger and more influential our profession will be.

# What Education Means To Me: A Philosopher

By Rev. P. J. Kingston

**The purpose of education is to cultivate the ability to think, to communicate thought, to exercise judgment, and to discriminate**

ONE OF the most striking things about education today is the amount of disagreement surrounding it. Many centuries have elapsed since one man first attempted to pass on some knowledge to another; a tremendous amount of literature has been collected in libraries, and educational theories without number have been tried, discarded, revived, or debated. Today we should know more about learning and teaching than men have ever known; we should — it is reasonable to assume — know pretty well what direction we want education to take, and yet in spite of all the accumulated knowledge on the subject, in spite of studies and surveys undertaken in community after community, major differences of opinion on the processes and goals of education not only continue to exist but seem to be multiplying. We sometimes find ourselves in the same quandary as the heroine of "Alice in Wonderland":

"Cheshire Puss . . . Would you tell me, please, which way I ought to go from here?"

"That depends a good deal on where you want to get to," said the Cat.

"I don't much care where . . ." said Alice.

"Then it doesn't matter what way you go," said the Cat.

"So long as I get somewhere," Alice added as an explanation.

"Oh, you're sure to do that," said the Cat, "if you only walk long enough."

Were these differences of opinion to involve only the proper size of school rooms, the most desirable arrangement of desks, or other matters pertaining to inanimate materials, no one would be deeply concerned; since they involve tomorrow's citizens — workers, homemakers, legislators, teachers, writers — an anxious interest is entirely proper.

### Criticism the Fashion

It has been fashionable for some time among college people to criticize public school teaching and, still more bitterly, the teachers' colleges, schools of education, and normal schools which prepare for it. School people for their part have come to believe that colleges have no grasp of public education except as it concerns themselves and no interest in it except to criticize. This state of mu-

A paper read to the 5th Maritime C.A. Students Conference, Moncton, June, 1953

tual acrimony is understandable, if not excusable, since it is a particularly confusing result of the expansion of the public school (in numbers of students, activities, courses, etc.). It seems clear that when the need for armies of teachers became evident, liberal colleges and universities faced a decisive choice. Either they might train these teachers as they had those of earlier generations, in which case very serious changes would have to be made in the conventional college curriculum; or else they might keep their traditional dedication to higher studies, in which case they would surrender the training of teachers to new institutions and themselves increasingly lose touch with the schools. The element of expense also entered in. For these and other reasons, the second of the two choices was in fact made by the colleges, no doubt in part unconsciously and out of inertia. The consequences have been, not only misunderstanding between them but loss of any continuing interchange whereby each group might inform and influence the other.

The growth of our educational system has brought into schools crowds of students so immensely varied in abilities and outlook that the chief problem for the teachers is not so much to know the subjects which are taught as to know what to teach and how to teach it. Hence, the emphasis is on method. We must, of course, grant that methods are of importance but of secondary importance only, for means and methods derive their very reason for being from their relation to that end or goal to which they are the means. Were we to cultivate the things which are means to educational goals without considering the ends, we would not in fact be developing them as means at all. They would cease to lead to any specific end. There would be an aimless process in which means developed in a variety of ways tend to multiply indefinitely until the practical science of education ceases to be either practical or scientific.

### The Cult of Mere Means

In the 1952 report of the chairman of the Carnegie Foundation for the Advancement of Teaching, we find the complaint that educators have left unanswered the question of the why and wherefore of life. The report declares that "this disregard for the end coupled with the cult of mere means is precisely the principal disorder in contemporary education". Dr. Smith, president of the University of Toronto, said in a recent address: "You are all probably familiar with the term that is used in sailing — 'to lose way'. A ship loses way when her impetus is gone, when she no longer cleaves the water with a forward surge, but wallows helplessly in the waves. Applying this nautical metaphor to ourselves, I think we would all agree that what keeps us under way is our sense of purpose and spiritual direction; if we lose that sense of a purpose greater than ourselves, we lose our way, and however feverish our activity may be, we are really aimless and adrift."

Education has its own specific nature and essential aims which deal with the formation of the man and the inner liberation of the human person. The aim and end of education are to bring out and strengthen man's faculties — physical, intellectual, and moral; to call into healthful play his manifold capacities; and to promote the harmonious exercise of these faculties with due proportion.

As recently as a century ago, doubt about the purpose of education did not exist: education was to train the Christian citizen. Nor was there any doubt how this training was to be accomplished. The student's logical powers were to be formed by mathematics, his taste by

Greek and Latin classics, his speech by rhetoric, and his ideals by Christian ethics and philosophy. College calendars commonly began with a specific statement about the influence of such a training on the mind and character. The reason why this has largely disappeared stems from social and economic changes and the tremendously expanded fields of knowledge. For some decades the mere excitement of enlarging the curriculum and making place for new subjects, new methods, and masses of new students seems quite pardonably to have absorbed the energies of schools and colleges. It is fashionable now to criticize the leading figures of that expansive time for failing to replace or even to see the need of replacing the unity which they destroyed. But a great and necessary task of modernizing and broadening education waited to be done, and there is a great deal of credit due to those who accomplished it. But again the question of unity has become insistent. We are faced with a diversity of education which, even though it has many virtues, works against the good of society by destroying the common ground of training and outlook on which society depends.

### "General" and "Special" Education

Education is broadly divided into general and special education. The term "general education" is somewhat vague and colourless; it does not mean some airy education in knowledge in general, nor does it mean education for all in the sense of universal education. It indicates that part of a student's whole education which looks first of all to his life as a responsible human being and citizen, while the term "special education" indicates that part which looks to the student's competence in some occupation. These two sides of life are not entirely separable, and it would be false to imagine that education for the one is quite distinct from education for the other. Every human occupation — carpenter, doctor, engineer — has its own specific goal, that is, the end peculiar to that line of work. Before a human being becomes a carpenter, a doctor, an engineer, a lawyer, he is already a man.

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There is then an end of man considered simply as man. No matter what kind of work he performs, no matter where or when he lives, each and every man must live a specifically human life to attain the goal of human striving. If you consider man as a unit of the human species, this end is one and the same for all men. Therefore a complete and integral notion of the human person (which is a necessary pre-requisite to any adequate science of education) must be religious as well as philosophical, because man's existence depends upon God.

Clearly, general education has somewhat the meaning of liberal education for if one clings to the root meaning of liberal as that which befits or helps to make a free man, then general and liberal education have identical goals.

### Opposition to Liberal Education

The opposition to liberal education stems largely from historical sources. The concept of liberal education first appeared in a slave-owning society, in which the community was divided into free men and slaves. While the slaves carried on the specialized occupations of menial work, the free men were primarily concerned with the rights and duties of citizenship. The training of the slaves was purely vocational; but as the free

men were not only a ruling but a leisure class, their education was exclusively in the liberal arts without any utilitarian tinge. The free men were trained to pursue the good life; its aim was to produce a rounded person with a full understanding of himself and of his place in society and in the cosmos.

Our modern society clearly does not regard labour as odious or disgraceful; on the contrary, in some quarters, leisure is regarded with suspicion. Thus we attach no odium to vocational instruction. There seems to have been even a conspiracy against intellectuality. The earnest student who loves learning is sometimes nipped in the bud. Name-calling was the first weapon used in this conspiracy. The student was called a "grind" and dishonoured among his peers. Then as the vocabulary of slang changed, he was a highbrow and more recently "an egg-head", and he was laughed out of the big chair in the browsing room, or the straighter chair in the library, where he belonged by inheritance, perhaps, and by inclination and talent. Moreover, in so far as we reject the idea of free men who are free because they have slaves, we are apt to deprecate the liberal education which went with this former aristocratic structure. However, it should follow that since all are free men, all human beings stand in need of an ampler and rounded education. The task of our society is to preserve the ancient ideal of liberal education and to extend it as far as possible to all the members of the community. To believe in the equality of human beings is to believe that the good life and the education which trains the citizen for the good life are equally the privileges of all.

### An Age of Specialism

The opposition to general education does not stem from historical causes alone. We are living in an age of specialism, in which the road to success for the student often lies in his choice of a specialized career, whether as a chemist or an engineer or as a specialist in some form of business. Each of these specialties makes an increasing demand on the time and the interest of the student. Specialism is the name for advancement in our society, and yet we must, I think, recognize the fact that a society controlled wholly by specialists, as such, is not a wisely ordered society. The business of providing for the needs of society breeds a great diversity of special occupations and a given specialist does not even speak the language of the other specialist. In order to discharge his duties as a man and as a citizen adequately, a person must somehow be able to grasp the complexities of life as a whole.

The aim of education then must be both to train a man to become an expert in the general art of the full life as a man and as a citizen, and to prepare an individual to become an expert in some particular vocation or art. The role of the school is to teach the very heart of civilization itself. There is something mysterious, humanizing, and civilizing about the kind of knowledge an education is supposed to give. The role of the school is to impart that kind of knowledge which has been discovered by human reason, arranged in order by human reason, and proven by human reason to be true. In the Middle Ages it was also called science. In recent times men have become absorbed with a fractional part of it and have limited the meaning of the term "science".

### Old Certainties Questioned

Two complementary forces are at work in our culture; on the one hand, an ideal of man and society, distilled from the past but at the same time transcending the past as standards of judgment and truth valid in themselves. As Dr. Smith

of Toronto says: "It is the task of education to conserve and transmit the cultural heritage of our race." On the other hand there is the belief that no existent expressions of this ideal are final but that all alike call for perpetual scrutiny and change in the light of new knowledge. Specialism is usually the vehicle of this second force. As William Heard Kilpatrick, the champion of progressivism, says: "There is no telling what may happen. In James's startling words the lid is thus taken off the universe. The future is yet to be determined. No prior formulation will certainly hold in any realm. All old certainties are questioned." If tradition and culture are to grow and flower, then general or liberal education must be encouraged. Education must look to the whole man. It has been wisely said that education should aim at the good man, the good citizen, and the useful man. By a good man is meant one who possesses an inner integration, poise, and firmness which in the long run come from an adequate philosophy of life. It must set up and maintain valid standards and ideals.

Specialism, of course, comprises a wider field than vocationalism, and general education extends beyond the limits of mere literary occupation. Sometimes a scientist will, to save himself from narrowness, take a course in English literature, or perhaps read poetry and novels, or just generally occupy himself with the fine arts. This scientist wrongly interprets the distinction between liberal and illiberal in terms of the distinction between the humanities and the sciences. Aristotle and Cicero would have been very much surprised to hear that geometry, astronomy, and the sciences of nature in general are excluded from the humanities. There is also in this practice the implication that liberal education is something only genteel. It reveals itself too in the attitude of the student towards his required courses outside his major field as something to get over with so that he may engage in the business of serious education, identified in his mind with the field of concentration.

### Differences in Method

A general education is distinguished from special education not so much by subject matter but in its method and outlook no matter what the field. Literature when studied in a technical fashion gives rise to a special science of philology. Specialism is interchangeable not with natural science but with the method of science, the method which abstracts material from its context and handles it in complete isolation. The reward of the scientific method is the utmost degree of precision and exactness, but specialism as an educational force does not provide an insight into general relationships.

Even elementary courses in colleges are very often devised as an introduction to specialism within a department; in short, introductory courses are planned for the specialist not for the student seeking a general education. The young chemist in the literature course and the young writer in the chemistry course find themselves in thoroughly uncomfortable positions so long as the purpose of these courses is primarily to train experts who will go on to higher courses rather than give some basic understanding of science as it is revealed in chemistry or of the arts as they are revealed in literature.

Just as we regard the courses in concentration as having a definite relation to one another, so should we envisage general education as an organic whole whose parts join in expounding a ruling idea and in serving a common aim. And to do so means to abandon the view that all fields and all departments are equally valuable vehicles for general education. Tradition points to a separation of learn-

ing into three areas of natural sciences, social sciences, and the humanities. The study of the natural sciences looks to an understanding of our physical environment so that we may have a suitable relation to it. The study of the social sciences is intended to produce an understanding of our social environment and institutions in general so that the student may achieve a proper relationship to society, not only local society but the great society of men and, by the aid of history, the society of the past. The purpose of the humanities is to enable man to understand man himself in his inner aspirations and ideals.

### Purpose of Education

Students at examinations probably do not remember more than 75% of what they have been taught. Pondering this the pessimist might well conclude that education is a wholly wasteful process. But education is not a process of stuffing the mind with facts; it is not even the imparting of knowledge but the cultivation of certain aptitudes, abilities, and attitudes. These abilities should be: *to think effectively, to communicate thought, to make relevant judgments, to discriminate among values.*

These are some of the things which would indicate what education means to me. Many colleges are discarding the liberal arts in favour of technical subjects, and in consequence the high school years become for many the only period in which the humanities can be taught. Obviously if the high schools also shunt aside liberal arts to make way for more technical instruction—spending less time in teaching the students how to think than how to do — the avenue to the humanities and general education will become still narrower. The end of that movement is technical specialization accompanied by intellectual immaturity. To solve the whole problem of educating the masses of the people of various intellectual abilities by the introduction of shop-work and practical courses to the exclusion of general education is only expediency. Will expediency win in a battle in which it already has amassed a disturbing superiority?

# A Canadian Adventure

By Sir Ian Bolton, Bt., O.B.E., L.L., J.P.
*Vice-President,*
*Institute of Chartered Accountants of Scotland*

**Our delightful guest at last year's annual meeting describes his experiences**

IN JULY 1953 I went to Ottawa to represent Lord Rowallan and U.K. Boy Scouting at an all Canadian jamboree. After it I planned a quick trip across Canada to Victoria and back to see old Scout and other friends.

When in Toronto I received an airmail from the president of the Scottish Institute that he had been invited to attend as a guest the annual convention of the Canadian Institute of Chartered Accountants in September: could I go instead? This was followed by the arrival at the house of the secretary of the Canadian Institute, Mr. Clem King, a friend of mine from a previous visit and also from the International Congress, supported by an urgent letter from his president, Mr. Lorn McLean, from British Columbia. It was impossible to alter my already arranged itinerary, so that it meant turning round at Montreal and repeating the trip across Canada — four nights and four days by train and steamer to Victoria and the same back — 6,000 miles in all. Distance is a major factor in all Canadian affairs. But I was "in Canada" and only too pleased if possible to represent the Institute and have the extra experience and holiday! Clem King and I did some rapid arranging in the 36 hours I had in Toronto and found that all financial and transport problems, including changing reservations on B.O.A.C., were solvable. So I gladly accepted.

Each Province in Canada has its own Institute of Chartered Accountants. The Canadian Institute is composed of representatives in agreed proportions from the Provinces. By agreement it controls from Dominion Hall in Toronto the provincial final examinations and most of the provincial intermediate examinations, because in Canada all educational matters are reserved to the provincial governments. The actual training of each apprentice is controlled by his provincial Institute. The provincial Institutes also deal with discipline of members and supply the funds for the Canadian Institute's work.

In due course the time arrived when I crossed the Rockies for the third time in four weeks and on Sunday, September 5, arrived at the Empress Hotel, Victoria. The Dominion Council and its committees had been in session since the previous Friday.

My first "occasion" on arrival was attendance at a cocktail party and buffet supper for the Council at the beautiful

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home of Mr. Gerald Fitzpatrick Dunn, chairman of the local convention committee in Victoria. On Monday and Tuesday I was invited to attend all meetings of the Council. The work being done is reflected in the annual report referred to later. On Monday evening the president gave a reception to the Council, and on Tuesday morning the bulk of the members and their wives attending the conference — 450 in all — registered at the convention office.

Tuesday afternoon saw the official opening, with an address by Professor C. D. MacPhee, Director of the School of Commerce, University of British Columbia, on "Audit of Management Methods and Systems".

This was a very far-reaching paper, attempting to answer the following questions posed by himself:—

(1) where does the process of audit fit into the average system of management;
(2) what are the principles involved; and
(3) what should be their application?

As a business man and commercial director turned professor, he developed an argument that auditors must greatly enlarge the scope of their work to *meet the needs of investors,* because 90% of recent failures had been due to lack of good management. The address practically boiled down to envisaging the auditor's report as a report on the prudence of management. He did end by pointing out the danger of the auditor just slipping into the position of being a critic or advisor of the management instead of being an auditor. While the Canadian C.A.'s I met were far-seeing men and very open-minded, the suggested duties of auditors proposed by the professor seemed rather much for them to swallow, just yet anyhow.

That evening the British Columbia Institute entertained everyone in the hotel's crystal gardens to a reception, buffet supper, and dance. The entertainment included a very fine display of ballet swimming by a local ladies' club and a most amusing display of diving by three male experts in the huge swimming pool.

Wednesday morning was devoted to two sessions — one on "Uniform Company Law". The speaker wanted Canada to follow the British Companies Act, 1948, but brought out the essential difference between the attitude of British and Canadian auditors, especially to the verification of inventories (stocks). I found that it is customary for the auditor to attend stocktaking, make test checks and even to take stock sheets home with him at night during stocktaking. (The influence of the U.S.A. and the *McKesson* v. *Robbins* case is very strong.)

The second was on "Depreciation and Capital Cost Allowances". As I had never seen or heard of the sections of the Act which were being discussed, nor of Bulletin No. 42 (U.S.A.), it was very difficult to follow the paper and discussion. But I gathered that the profession has a great grievance in that allowances for income tax under this Act must be shown in the balance sheet and in a certain way, and this causes difficulty. At three minutes to lunch time someone got up and asked the chairman if I would explain the working of initial allowances in Great Britain. My suggestion that I might see the lecturer privately and that we all go to lunch was adopted amid applause.

That day after lunch the Royal Canadian Navy laid on a highly successful cruise into Puget Sound in a cruiser and destroyer. The weather was beautiful and everything admirably organized and interesting. Owing to some special atmospheric effect, however, the sulphuric acid fumes on the cruiser caused all the ladies' nylon stockings to disintegrate.

Fortunately only stockings appeared to be involved.

At 10.30 a.m. on Thursday came the annual general meeting, presentation of the annual report, and election of Council.

There was little discussion and most of the committee reports in the annual report were of purely Canadian interest, *e.g.* the Bank Act, the Companies Act, and Committee on Government Accounts.

The report by the Committee on Research was interesting. This committee has issued a bulletin on reserves, in effect recommending that reserves should be as understood in the Companies Act, 1948.

The Sub-Committee on the Changing Value of the Dollar (this sounded familiar) has suspended its activities owing to differing views (this sounded even more familiar).

A great deal of research is going on into accountancy matters, for instance analyzing the financial reports of Canadian companies and preparing statistics. The secretary of the Institute has been appointed director of research and given an assistant secretary.

The Taxation Committee makes recommendations to the Dominion Government on income tax and has meetings with Ministers and their Deputies.

A strong Committee on Training and Recruitment of Apprentices is preparing a report when results of a very elaborate questionnaire come to hand and have been analyzed.

The Canadian Tax Foundation should also be mentioned. It is a voluntary non-profit-making body, composed of members of the Canadian Bar Association and members of the Canadian Institute, which studies taxation matters and submits the views of both bodies to the Government of the day. It seems to have achieved considerable standing, as one might expect, though it has only been in existence for six years.

Thursday evening was given over to celebrations — as I had no evening dress clothes I celebrated in my Boy Scout kilt! At 6.30 p.m. there was a reception by the visiting Institutes.

At 7.30 p.m. there was a banquet for 560 people which began long after 8 p.m. under the chairmanship of the retiring president, Mr. Lorn McLean, a very well-known and eminent business man, *i.e.* a non-practising member — quite a unique experiment I understand. He gave an account of his stewardship at some length. As a Stirlingshire man I was delighted to be present when he announced and installed as president of the Canadian Institute for the ensuing year a Stirling High School F.P., Mr. Walter Macdonald, a partner in the firm of Millar, Macdonald & Co., of Winnipeg.

During the speechmaking, both Mr. Thornton Douglas, vice-president of the American Institute, and I were given an opportunity of conveying fraternal greetings from our Institutes. I told them of our centenary in 1954.

Dancing and celebrations before going to bed lasted well into the early hours of the morning. Later in the morning we got up again and the convention dispersed.

The goodwill and hospitality of our Canadian hosts was terrific. There was never an idle or dull moment. Meeting such grand wide-thinking people was a great experience and well worth while. I cannot be too grateful to them for all the kindness they showed to the Institute's representative.

# Recent Books

**Chartered Banking in Canada, by A. B. Jamieson; published by The Ryerson Press, Toronto; pp. 394; price $5.00**

This book deals in a clear and informative way with both the history of banking in Canada and the operating practices of the banks. It will doubtless succeed to the place now occupied by the book "Canadian Banking" by Stewart Patterson which has been the accepted authority on the subject until now.

While the first part of the book, entitled "Foundations and Development", deals primarily with banking in Canada, it actually provides a very interesting and informative outline of the general development of business and social structures in Canada from 1820, when the first bank appeared, up to the present time. As such it is worth reading by anyone interested in the story of Canadian progress. The subject is divided into chapters covering periods in which differing economic cycles affected the economy of Canada.

Public accountants will be particularly interested in the development of examinations by independent auditors, which can be traced from its inception in 1906 on a voluntary basis to the present requirements for a mandatory check by two independent auditors.

The second part of the book deals with the techniques employed in handling banking transactions, dealing with loans, foreign exchange, etc. Most accountants, however, should be able to comprehend this section and will derive from it a good understanding of the methods and procedures of the banks. Two chapters will be of particular interest to accountants: one on "Analysis of Financial Statements" and the other on "Audits and Inspections". The chapter on analysis of financial statements includes two comments to which we should give some attention; firstly, that "since the discovery of an extraordinary case of fraudulent inventory figures, it has been the practice of auditors to make sufficient test checks to satisfy themselves reasonably regarding the existence and valuation of inventories" and, secondly, that instead of valuing fixed assets at cost less depreciation "a more realistic method is replacement cost less depreciation". If, in stating that the auditors satisfy themselves as to the existence of inventories, an observation of physical inventory-taking or a similar procedure is contemplated, there may be some question as to how universally this practice is followed by independent auditors in Canada. As for the valuing of fixed assets at replacement cost less depreciation, accountants generally would not accept this practice for the purpose of the accounting records, although they would agree that it is quite proper for the banker to do so in estimating the real worth of a business.

While primarily of interest to bankers and students interested in Canadian banking, this book should prove of interest to anyone engaged in business in Canada, particularly in the current year when The Bank Act is receiving its decennial revision. Accountants, who in the nature of their work are constantly dealing with banking transactions and with the chartered banks, should find this book worth reading.

T. A. M. HUTCHISON, F.C.A.
*Toronto, Ontario*

**A History of the Hall of the Institute of Chartered Accountants in England and Wales, by John H. Stern, M.A.; published by Gee & Co., London, pp. 102 and index; price 16/3d**

Among the many interesting historical features of the City of London are the halls of the various ancient guilds and companies of tradesmen and craftsmen. When the Institute of Chartered Accountants in England and Wales received its charter in 1880, a plan was put forward to provide a meeting-place and headquarters which, while modern, would follow along the lines of these time-honoured institutions.

It is of this plan and its fulfilment that John H. Stern writes in "A History of the Hall of the Institute of Chartered Accountants in England and Wales". With the assistance of officials of the Institute and the editor of *The Accountant*, Mr. Stern has amassed more detail than one would believe it possible to unearth in connection with a single building. With the possible exception of a quotation from an opening speech of singular banality, all of it is relevant and interesting.

A chapter dealing with the site of the hall traces its earliest association with accountancy and, in addition, gives interesting glimpses of ancient London. In later chapters the growth of the profession is described along with the growth and development of the hall. The author has devoted a great portion of his work to a complete and detailed record of the hall's architectural features, sculpture, and works of art. And well he may. It has been described by a noted authority as a "building of which any institute in England or the world might be proud".

In all things Mr. Stern's account is strictly factual and to some it may seem a pity that he has allowed no flicker of personal opinion to colour his narrative. The final chapter consists of a series of sketches of the careers of the various artists and architects connected with the building, notably John Belcher, R.A., who is responsible for the original design.

The many excellent illustrations of maps, plans, and photographs show various aspects of the hall and those connected with its creation. The exterior of the building, as seen on the dust jacket, while possibly a little florid for some modern tastes, is undeniably a handsome structure which is standing up well to the test of time. This book should be of particular interest to those accountants who have affiliations with the Institute in England and Wales.

RENNY ENGLEBERT,
*Toronto, Ontario*

**Handbook of Auditing Methods, by J. K. Lasser, C.P.A.; published by D. Van Nostrand & Co. (Can.) Ltd., Toronto; pp. 749 and index; price $14.25.**

"Handbook of Auditing Methods" consists of two sections: Part 1 contains 80 pages written by Mr. Lasser on general auditing methods, and Part 2, 670 pages describing particular auditing techniques for 70 different industries, each written by a different author.

The first part is an excellent summarization of general auditing procedures. Quite properly it assumes the reader to have a sound knowledge of accounting and some experience in auditing and in the preparation of financial statements. It presents clearly and succinctly, in the form of "check lists" and audit programs, the why's and wherefore's of the steps ordinarily taken in the examination of the annual accounts of a commercial business concern and gives many "reminders" on points which are all too often overlooked, even by experienced practitioners.

Rarely has so much valuable informa-

tion been condensed in such readable form as in the 29 pages of the chapter entitled "How to make an audit". This bit alone is well worth the attention of every person in active charge of auditing assignments.

There follows another well presented chapter on the determination of good internal control. In the form of questions, answers, and reminders, it describes how to evaluate the existing system of internal accounting control, explains the results which should be achieved, and lists the shortcomings which occur most frequently.

The second part is a helpful guide to the special auditing problems which arise in different types of business. This part is designed to assist the practitioner in tackling an assignment for an industry in which he has had no previous experience, and each business or industry is dealt with by an expert in the particular field. To obtain uniformity of presentation, each industry article is written under the following headings:

I Description of the industry
II How to obtain information about the industry (all U.S. sources)
III What to build up before the audit
IV How to prepare the audit program
V Specific procedures for audit of assets and liabilities
VI Specific procedures for audit of income and expenses
VII Typical frauds to be watched for and how to detect them

The articles themselves appear to cover with reasonable adequacy the principal auditing features peculiar to the industry. They represent something of a "Reader's Digest" edition of the points to watch for under each of the foregoing headings. The summaries are good reading for any auditor and should be useful particularly to the sole practitioner and the smaller auditing firms whose experience with a wide variety of businesses may be somewhat restricted. Readers in Western Canada will be interested in the chapters on natural gas producers, oil producing industries, oil well drilling contractors, and farms and ranches, but for Canadians these articles suffer somewhat because in these industries special income tax provisions have an important bearing on accounting, and all references are to United States tax laws. Also, for Canadian purposes, it is unfortunate that there are no articles on mining companies, logging companies, fishing companies, or public utilities.

J. R. CHURCH, F.C.A.
*Montreal, Quebec*

## THE SIGNIFICANCE OF MOTIVES

In *Gregory* v. *Helvering*, 293 U.S. 465 (1935) . . . . the Supreme Court of the United States emphasized the principle that it was not sufficient that a tax transaction conform to the express language of the statute but rather that the Court reserves the right to look behind the outward transaction into the basic business reality underlying it. Because of such decisions, motives and purposes become of extreme importance; and although these are most easily inferred from the outward shape of transactions, it is possible for a skilful lawyer and a clever controller to prepare reports and to write into minutes tendentious language which may indicate that nontax motivations were of dominating importance in actuating the transaction. (From "The Lawyer and the Controller Consider Corporate Morality", by Christian B. Peper, LL.M.)

—*The Controller*, October 1953

# Professional Notes

## News from the C.I.C.A.

### More On The Chartered Accountants Building

On May 27 Canada's first Chartered Accountants Building will be opened at 69 Bloor Street East, Toronto. Of structural steel with a limestone front and light brick sides, the $300,000 building will provide office accommodation for the Ontario Institute on the ground floor and for the Canadian Institute on the second floor. In the basement there is to be a lecture hall capable of seating 150 people, and on the second floor additional space has been rented to the Ontario Cancer Treatment and Research Foundation.

The building is air-conditioned and all the offices equipped with fluorescent lighting and acoustic tile ceilings. It will be heated by a low pressure furnace with capacity to heat a further three floors when expansion becomes desirable.

An asphalt paved parking lot at the rear of the building will allow room for at least 30 cars.

### The President's Western Trip

"Institute Head, Man with a Message" — was one of the more striking newspaper headlines in connection with Mr Walter Macdonald's recent trip throughout the West, which took him to Edmonton, Calgary, Vancouver, and Victoria. The Edmonton meeting, attended by the president of the University of Alberta and the Provincial Secretary, was a luncheon at which new C.A.'s were presented to the gathering by the heads of the firms to whom they had been articled. The meeting in Calgary took the form of a dinner dance attended by around 200 persons, and Mr Macdonald presented the certificates to successful candidates at both functions.

Speaking to the group of newly graduated chartered accountants in Calgary, Mr Walter Macdonald stressed Canada's bright future and the part they can play in its development. "I advise you to stay in Canada; Canada needs you. Everywhere I go I have found the pulse of Canada beats strong; everywhere I have found our profession taking a greater part in the development of our country." He advised his listeners not to lose the capacity to study. "The field is now wide open to you," he said. "Heretofore it was restricted to the somewhat narrow confines of examinations; now you are free to choose your own avenues of study, to specialize in what appeals to you."

On January 11 in Vancouver, the President met the Council of the British Columbia Institute and B.C. members acting on C.I.C.A. committees. On January 15 he was guest of honour at a reception in Victoria given by Mr. Pat Dunn, president of the B.C. Institute. His schedule in the city included two press interviews and a talk to 37 members in which he dealt with his presidential activities and the increasing responsibilities of the profession as a whole.

### Taxation Committee

Laird Watt of Montreal, chairman of the Taxation Committee, and C. L. King visited Ottawa on February 19 and met the Ministers of Finance and National Revenue. They were accompanied by Stuart Thom, Toronto, and Palmer Howard, Montreal, chairman and secretary respectively of the taxation section of the Canadian Bar Association. The purpose of their visit was to present a joint brief on recommendations for amendments to federal tax statutes. Further talks were held during the day with the Deputy Ministers and senior officials of both Departments. A press release on the brief was sent to all daily newspapers, financial weeklies, and monthly trade journals across the country. Copies of the brief were also forwarded to the editors of the large circulation dailies.

## ALBERTA

McCannel & Gee, Chartered Accountants, announce the admission to partnership of Mr Kenneth W. Quinn, C.A. Henceforth practice of the profession will be carried on under the firm name of McCannel, Gee & Quinn, Chartered Accountants, with offices at 713 McLeod Bldg., Edmonton.

* * *

Messrs W. R. McKinnon, C.A. and Gordon C. Ennis, C.A. announce the opening of an office for the practice of their profession in the J. H. Kemp Block, Olds.

## BRITISH COLUMBIA

Mr Blake C. Morton, C.A. announces the opening of an office for the practice of his profession at 310 Credit Foncier Bldg., 850 W. Hastings St., Vancouver.

## ONTARIO

### Tickets for Opening of the Chartered Accountants Building

Members and students of the Ontario Institute are advised to obtain their tickets to the opening day luncheon well in advance of May 27. Unfortunately, considerations of space at the Royal York Hotel will limit attendance to 1000 persons.

### Public Accountants Council

A. S. Merrikin, F.C.A. of Ottawa, was elected president of the Public Accountants Council for the Province of Ontario at its annual meeting on February 19. Other members of the new executive are: John S. Entwistle, C.P.A., *vice-president;* J. G. Brown, F.C.A., *secretary;* H. J. Cornish, C.P.A., *treasurer.*

* * *

Starr & Barrett, Chartered Accountants, 85 Richmond St. W., Toronto, announce the admission to partnership of Mr J. Sherman, C.A.

* * *

Grossman, Karp & Co., Chartered Accountants, announce the removal of their offices to Ste. 4, 206 Bloor St. W., Toronto.

### Ottawa Chartered Accountants Club

Guest speaker at the January luncheon meeting of the Ottawa Chartered Accountants Club was Claude S. Richardson, Q.C. who spoke on "Chartered Accountants and the Law".

### The C.A. Club of Western Ontario

On January 26 C. L. King, executive secretary of the C.I.C.A., spoke to a meeting of the Chartered Accountants Club of Western Ontario on the work of the Canadian Institute.

The sixth annual At Home of the Chartered Accountants Club of Western Ontario was held on Friday, February 12, at Hook's Restaurant near London.

Guests of honour were Mr W. M. Brace, F.C.A., vice-president of the Ontario Institute of Chartered Accountants, and Mrs Brace, C.A. Other guests included Mr and Mrs F. W. Dowler and Mr and Mrs J. W. Cram. Mr Dowler and Mr Cram are well-known London barristers who have assisted with the students' examination study groups.

Each lady present received a rose corsage and cologne, and Mr R. E. Pennington won the mantel radio which was given as a door prize.

The At Home was under the convenership of Mr Jack Mennie, vice-president, and was attended by more than 50 couples.

Before the At Home Mr K. W. Lemon, C.A., and Mrs Lemon were hosts to the guests and executive at a dinner at the London Hunt and Country Club.

* * *

R. H. Langlois & Co., Chartered Accountants, announce the admission to partnership of Mr Carl A. Hauck, C.A. Henceforth practice of the profession will be carried on under the firm name of Langlois, Atkinson & Hauck, Chartered Accountants, at 18 Temperance St., Toronto.

## QUEBEC

Goldberg & Messer, Chartered Accountants, Ste. 508, 1255 Phillips Sq., Montreal, announce the admission to partnership of Mr Peter Wolkove, C.A.

* * *

Mr George Berlind, B.Com., C.A. announces the opening of an office for the practice of his profession at 1880 College St., Montreal 9.

# News of Our Members

Mr Fred G. Cottle, C.A. (Alta.), has been appointed general manager in charge of the supply and transportation of all crude oil and products for Imperial Oil Limited, Toronto.

* * *

The new president of the Edmonton Chamber of Commerce is Mr Allan D. McTavish, C.A. (Alta.).

Mr Desmond R. Smith, C.A. (Que.; B.C.) spoke to the Kiwanis Club of Montreal on January 14 on the increase of property values should the city build a rapid transit system.

* * *

Mr R. E. McElligott, C.A. has been appointed secretary-treasurer of Cossor (Can.) Limited, Halifax.

# Obituaries

## Frank Ernest Roberts

The Institute of Chartered Accountants of Ontario regrets to announce the death on February 4 of one of its older members, Frank E. Roberts, F.C.A.

Mr. Roberts was born and educated in Toronto and had been a member of the Institute since the year 1906. During his active years in the profession he always strove loyally to uphold its high standards.

A man of retiring disposition, he held the respect and goodwill of his associates and the confidence and high regard of all those with whom, in the carrying on of his profession, he was brought in touch.

To his family the members of the Institute wish to express their sincere sympathy.

## George E. Baskie

The Institute of Chartered Accountants of Saskatchewan announces with deep regret the untimely death on January 12 of George E. Baskie, C.A. at his home in Southbridge, Mass.

Mr Baskie was born in Pittsburgh in 1891 but as a child moved to western Canada with his family. After graduation from the University of Saskatchewan he became accountant for the City of Regina at the age of 21. He was admitted to the Saskatchewan Institute in 1918.

In 1923 he became associated with the American Optical Company in Massachusetts as a travelling auditor. In 1937 he was appointed controller and in 1948 treasurer of the company. In 1953 he was made vice-president in charge of finances.

Mr Baskie served a term as president of the Boston Control of the Controllers Institute of America and was a member of the National Association of Cost Accountants. A 32nd Degree Mason, he was also a Shriner and a member of Kismet Temple, Brooklyn, N.Y.

To his wife, mother, and family the Institute extends its heartfelt sympathy.

## IF YOU CHANGE YOUR ADDRESS

Each month an increasing number of copies of *The Canadian Chartered Accountant* are being returned to us undelivered. For the most part our readers are prompt in letting us (or their provincial Institutes) know when they move to a new address. Sometimes, however, we find out the hard way and then have considerable difficulty in tracking down the elusive addressee.

We would ask all our readers — members, students, and general subscribers — to give notification of a change of address as soon as possible in order that we might continue the monthly mailing of their magazine without a lapse.

# The Students' Department

J. E. Smyth, C.A., Editor
*Correspondence with the editor is cordially invited*

## NOTES AND COMMENTS

THE revised syllabi for the intermediate and final uniform examinations of the Institutes of Chartered Accountants in Canada are reproduced below. These syllabi were adopted by the Provincial Institutes' Committee on Education and Examinations in September 1953, to become effective commencing with the 1954 examinations.

The changes in the syllabi have been primarily for the purpose of greater clarity. There has been no change made in the content of the syllabus for the intermediate uniform examination papers. The final examination syllabus now states specifically that students are expected to have "a reasonable knowledge of recent developments as portrayed in authoritative accounting journals and the pronouncements of accounting societies", a requirement that was implied in the former syllabus. In addition, the specific allocation of cost accounting questions and tax questions to Final Accounting I and II papers respectively has been eliminated. It will be possible therefore to include tax and cost questions on any of the three accounting papers.

### THE INSTITUTES OF CHARTERED ACCOUNTANTS IN CANADA

### Syllabus of Intermediate Uniform Examination Papers

The intermediate uniform examination consists of four papers — two accounting and two auditing.

The intermediate papers require a thorough knowledge of *basic* accounting and auditing principles and procedures. These will include:

(a) the accounting treatment, presentation in the statements and auditing procedures of:

(i) balance sheet items including at least the following:

— cash and bank balances
— accounts and bills receivable
— inventories
— prepaid expenses
— land, buildings, equipment. and other fixed assets
— securities
— wasting and intangible assets

(i) balance sheet items (*cont'd.*)
- — deferred charges
- — liens and other forms of hypothecation of assets
- — loans payable
- — accounts and bills payable
- — dividends payable
- — accrued charges
- — long-term liabilities
- — allowance for bad debts
- — accumulated depreciation
- — reserves
- — capital and surplus accounts
- — contingent liabilities

(ii) profit and loss and surplus items including at least the following:
- — revenues
- — costs of goods sold
- — salaries, commissions and wages
- — depreciation, amortization and depletion
- — administrative and general expenses
- — dividends

(iii) business transactions generally and including at least the following:
- — instalment and consignment sales
- — agency and branch operations
- — fund accounting
- — departmental accounting
- — distribution of overhead expenses

(iv) special features of limited companies such as:
- — organization and capitalization
- — issue and redemption of bonds
- — acquisition of a business
- — investment in subsidiaries
- — reorganization. mergers and consolidation
- — holding companies

(v) special features of partnerships such as:
- — organization
- — comparison with limited companies
- — capital increases and decreases
- — operations
- — admission and retirement of partners
- — dissolution and liquidation
- — sale to limited company

(vi) special features of joint ventures and sole proprietorship such as:
- — organization and operations

(b) financial statement preparation including:
- — legal requirements, form and content
- — notes to financial statements
- — trial balances, adjustments and closing entries
- — manufacturing, trading and profit and loss statements
- — surplus statements
- — balance sheets

(c) simple investigations including:
- — fire loss claims
- — fraud and its detection
- — effect of errors
- — valuation of a company
- — profit determination
- — capital and income expenditures

(d) statement analysis including:
- — ratio and percentage analysis
- — statements of source and application of funds
- — statements of comparative working capital

(e) systems and special records including:
- — controlling accounts and subsidiary ledgers
- — voucher registers
- — continuous inventory records

(f) internal control including:
- — definition
- — evaluation of effectiveness of and reliance upon system
- — accounting systems to provide effective internal control

(g) single and double entry bookkeeping including:
- — origin
- — records maintained
- — statements produced
- — conversion from single to double
- —statements from incomplete records

(h) auditing principles and standards relating to:
auditor's report
audit —
- — definition
- — objects
- — appointment of auditors including powers, legal duties and responsibilities
- — steps prior to commencement of
  - — audit program
  - — audit working papers
  - — internal audit — including reliance upon.

*September, 1953*

## THE INSTITUTES OF CHARTERED ACCOUNTANTS IN CANADA
### Syllabus of Final Uniform Examination Papers

The final examination consists of six papers — three accounting and three auditing.

The final papers require a broad general knowledge of all aspects of auditing and accounting including a reasonable knowledge of recent developments as portrayed in authoritative accounting journals and the pronouncements of accounting societies.

Without restricting the generality of the foregoing this will include a knowledge of:

the financial and cost accounting systems of and audit procedures for:
any industrial, commercial, financial, charitable, municipal, or other concern which is not peculiar to any particular section of Canada,
executorships and trusteeships,
the Income Tax Act, Canada, and regulations issued thereunder,
the Companies Act, 1934, Canada,
the Bankruptcy Act,
the Bank Act,
the Bills of Exchange Act,
the Succession Duty Act, Canada,
investigations,
reorganizations, mergers, and consolidations,
holding company accounts and consolidated statements,
accounting systems and budgetary control,
domestic and foreign agency and branch accounts,
bankruptcy and liquidation accounts,
the powers, duties, and liabilities of auditors,
professional ethics.

In all cases answers to questions on statute law are to be based upon the requirements of the statutes as at the 31st December immediately preceding the examination.

*September, 1953*

## CORRESPONDENCE

*Toronto. Ont.*

Sir: I have been following with interest the controversy on the suggested solution to question 2 of the October 1952 final examination in Accounting II, which was published in the August 1953 issue of *The Canadian Chartered Accountant* and which provoked correspondence in the November and December issues of 1953 and in March, 1954, the latter containing what purports to be the solution preferred by the Income Tax Division (whoever that might be). This last has prompted me to offer my own solution, which is different.

The real question, as I understand it, seems to be this: where a husband and wife contribute property to a personal corporation (the husband's contribution being valued at $175,000 and the wife's at $25,000) taking shares in the company in return, and the wife subsequently transfers some of her shares (of a par value of $14,900) to the husband, is the apportionment of the company's income for tax purposes between the husband and wife affected by the wife's transfer of shares to the husband? To this question Mr. William Gray, C.A. of Winnipeg answers "Yes" if the transfer was by way of sale, and this view is endorsed by the Tax Division, but *Toronto C.A.* says "No", whilst your own comment in the March issue seems to be rather non-committal.

Under ITA 1952 s. 67(3) the portion of a personal corporation's income allocated to a shareholder is dependent upon "the value of all property transferred or loaned to the corporation by the shareholder or any person by whom his share was previously owned". Since the husband has become the owner of shares previously owned by a person (his wife) who transferred property to the corporation s. 67 (3) applies and the husband's share in the company's income is increased accordingly. However, this does not conclude the question, because s. 21(1) of the Act declares that where a person has transferred property to his spouse, the income for a taxation year from the property shall be deemed to be income of the transferor and not of the transferee. In the case we are considering the wife transferred property (namely shares) to the husband, and it is reasonable to think that the husband's increased allocation of the

personal corporation's income which results from the transfer of that property is income *from* that property within the meaning of s. 21(1), and if that is so it would seem to follow that the income in question is income of the wife and not of the husband in virtue of the explicit language of s. 21(1).

It will be pointed out that the provisions of s. 67(1) and s. 21(1) appear to conflict on this question, that s. 67(1) says that income of a personal corporation shall be deemed to have been received by the shareholders as a dividend, whereas s. 21(1) says that income from property transferred by one spouse to the other shall be deemed to be the income of the transferor. Without going into elaborate argument my own view is that s. 21(1) prevails here, since it is a provision of a specific nature whose operation does not seem to me to affect the object and purpose of s. 67.

Both Mr. Gray and the spokesman for the Tax Division are of the opinion that s. 21(1) does not apply where there is a bona fide sale of property by a husband to his spouse. "Since the wife received full value in cash for the shares transferred to her husband", says the spokesman for the Income Tax Division, "the transfer is recognized as a bona fide sale, and the provisions of s. 21(1) would not be taken into account". I wonder if that is really the interpretation placed on s. 21(1) by the Income Tax Division. I know that in previous cases they have contended that a mere loan is a "transfer" within the meaning of the Act, which I find astonishing, but I have never yet heard the proposition advanced that a sale of property is not a transfer of that property by the vendor to the purchaser. Certainly no lawyer would ever think so. Indeed, the President of the Exchequer Court has put it as clearly as possible. In the case of *Fasken's Estate* v. *MNR* (1948) C.T.C. 265, he said:

"The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this result, whether direct or circuitous, may properly be called a transfer."

M. PIERCE, B.A., LL.B.

## PUZZLE

I drive 15 miles along a highway to work. Today I left home 10 minutes late, but by driving 15 m.p.h. faster than my usual average speed, I arrived on time. There is a speed limit of 50 m.p.h. on the highway. Did I violate it?

(Contributed anonymously by a reader in Vancouver in response to the editor's recent request for more puzzles.)

## SOLUTION TO THE MARCH PUZZLE

Let "a" = the rainfall on Sunday.

Then the total rainfall Monday - Saturday = 6a

and the total rainfall Sunday - Friday $= \frac{7}{6}(6a) = 7a.$

Re-arranging,

Total rainfall Sunday to Friday = 7a (1)

Total rainfall Monday to Saturday = 6a (2)

Subtracting equation (2) from equation (1),

Rainfall Sunday — Rainfall Saturday = a.

Since "a" is the rainfall on Sunday, it follows that no rain fell on Saturday.

## PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

### PROBLEM 1

### Intermediate Examination, October 1953

*Accounting I, Question 1 (20 marks)*

The following are the condensed trial balances of the L Mfg. Co. Ltd. as at 30 June 1953 and 1952:

L MFG. CO. LTD.

CONDENSED TRIAL BALANCES

| | as at 30 June 1953 | 1952 |
|---|---|---|
| **Debits** | | |
| Cash | $ 1,000 | $ 1,500 |
| Bank | 4,000 | |
| Accounts receivable | 85,000 | 74,000 |
| Land | 21,000 | 31,000 |
| Government of Canada Bonds | 70,000 | 50,000 |
| Prepaid insurance | 7,620 | 4,860 |
| Inventories | 69,750 | 62,530 |
| Buildings | 120,000 | 100,000 |
| Machinery and equipment | 200,000 | 165,000 |
| Office renovations less amounts written off | 3,600 | 3,960 |
| Dividends paid | 16,050 | 10,000 |
| | $ 598,020 | $ 502,850 |
| **Credits** | | |
| Bank overdraft | $ | $ 6,000 |
| Bank loan | 30,000 | 40,000 |
| Accounts payable and accrued charges | 57,030 | 59,950 |
| Capital — 5% preferred shares par value $100 | 125,000 | 100,000 |
| — common shares — no par value | 140,000 | 100,000 |
| Surplus | 68,800 | 51,440 |
| Profit for the year | 33,690 | 22,060 |
| Allowance for bad debts | 8,500 | 7,400 |
| Accumulated depreciation — buildings | 27,000 | 24,000 |
| Accumulated depreciation — machinery and equipment | 33,000 | 27,000 |
| Reserve for contingencies | 50,000 | 50,000 |
| Taxes on income payable | 25,000 | 15,000 |
| | $ 598,020 | $ 502,850 |

Additional information is obtained as follows:

(a) During the year the company disposed of the following fixed assets:

(i) A building which cost $5,000, against which depreciation of $2,000 had been accumulated, was sold for $4,800.

(ii) Machinery and equipment which cost $13,000, against which depreciation of $4,000 had been accumulated, was sold for $7,500.

(iii) Land which cost $10,000 was sold for $15,000.

(b) During the year ended 30th June 1953 the company issued for cash 250 5% preferred shares at $100 per share and 40,000 no par value shares at $1.00 per share.

**Required:**

( 5 marks) (a) A statement of changes in working capital for the year ended 30 June 1953.

(15 marks) (b) A statement of source and application of funds for the year ended 30 June 1953.

## A SOLUTION

(a)

### L. MFG. CO. LTD.

STATEMENT OF CHANGES IN WORKING CAPITAL

for the year ended 30 June 1953

| | June 30 | | Changes in Working Capital | |
|---|---|---|---|---|
| Current Assets | 1953 | 1952 | Increase | Decrease |
| Cash | $ 1,000 | $ 1,500 | $ | $ 500 |
| Bank | 4,000 | | 4,000 | |
| Accounts receivable — net | 76,500 | 66,600 | 9,900 | |
| Inventories | 69,750 | 62,530 | 7,220 | |
| Prepaid insurance | 7,620 | 4,860 | 2,760 | |
| Government of Canada Bonds | 70,000 | 50,000 | 20,000 | |
| | $ 228,870 | $ 185,490 | | |
| Current Liabilities: | | | | |
| Bank overdraft | | $ 6,000 | $ 6,000 | |
| Bank loan | 30,000 | 40,000 | 10,000 | |
| Accounts payable and accrued charges | 57,030 | 59,950 | 2,920 | |
| Taxes on income payable | 25,000 | 15,000 | | 10,000 |
| | $ 112,030 | $ 120,950 | | |
| Increase in working capital | | | | 52,300 |
| Working capital | $ 116,840 | $ 64,540 | $ 62,800 | $ 62,800 |

### L. MFG. CO. LTD.

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

for the year ended 30 June 1953

| | | |
|---|---|---|
| **Funds provided:** | | |
| *By profits*: | | |
| Net profit for year | | $ 33,690 |
| Add charges to profit and loss not requiring funds: | | |
| Depreciation — Buildings | $ 5,000 | |
| Depreciation — Machinery and equipment | 10,000 | |
| Write-off of office renovation expense | 360 | 15,360 |
| | | $ 49,050 |

| | | |
|---|---|---|
| *By sale of fixed assets*: | | |
| Land | $ 15,000 | |
| Building | 4,800 | |
| Machinery and equipment | 7,500 | 27,300 |
| *By issue of capital stock*: | | |
| 250 5% preferred shares at $100 each | $ 25,000 | |
| 40,000 no par value shares at $1 each | 40,000 | 65,000 |
| Total funds provided | | $141,350 |
| Funds applied: | | |
| *To purchase of fixed assets*: | | |
| Buildings | $ 25,000 | |
| Machinery and equipment | 48,000 | $ 73,000 |
| *To payment of dividends*: | | 16,050 |
| To increase in working capital (per statement attached) | | 52,300 |
| Total funds applied | | $141,350 |

## *EXAMINER'S COMMENT*

A common error made by candidates was to assume that the gain or loss on sale of fixed assets was already included in the profit figure.

## PROBLEM 2

### Final Examination, October 1953

*Accounting I, Question 1 (25 marks)*

You are responsible for the preparation and operation of a budget for a manufacturing company for the year ended 31 December 1954. The budget will be used to aid in controlling the business as well as to obtain a line of credit.

**Required:**

(20 marks) (a) A list of the statements or schedules (outlining the information that would appear in each) you would expect to receive from the various departmental managers and the additional information you would require in order to prepare your budget.

(5 marks) (b) What statements would be included in the completed budget which is to be presented to the Board of Directors?

## A SOLUTION

### (a) Schedules and Other Information Required from Departmental Managers in Preparation of Budget

(1) *Schedule of estimated sales setting out*:

- (i) Sales by products — volume and price
- (ii) Sales broken down by months; by products
- (iii) Sales by territories
- (iv) Sales by customer classes

(2) *Schedule of monthly estimated production by departments, setting out*:

- (i) Plan of production to meet the requirements of the estimated sales and to keep up the inventory in quantities by products.

(3) *Schedule of monthly and total costs of production by departments and products setting out*:

(i) Volume and dollar values of purchases of materials in order to meet the production schedule and maintain the inventories at a normal level while still taking advantage of discounts.

(ii) Hours and dollar values of labour required to meet production schedules by various classes of labour.

(iii) Fixed factory service costs, basis of allocation to departments and to production.

(iv) Variable factory service costs which will be incurred in meeting the production schedules by types of factory service, setting out basis of allocation to products and to departments.

(4) *Schedule of monthly and total distribution costs by products setting out*:

(i) Cost of marketing the anticipated sales volume by products — includes selling, advertising and delivery expenses.

(5) *Schedule of monthly and total estimated administration and financial expenses setting out*:

(i) Forecast of the necessary cost incidental to the administration and financing of the enterprise.

(6) *Detailed schedule of proposed additions and betterments to be made to plant and equipment setting dates and costs.*

(7) *Schedule of monthly and total cash transactions setting out*:

(i) Forecast of cash receipts and disbursements incidental to the operations as estimated above, to the provision of necessary working capital, to the provision for extensions and additions to capital assets, to the repayment of the company's long-term financial obligation, and to the payment of proposed dividends.

(8) *Other information*:

(i) Accounts receivable collection rate.

(ii) Terms of payment of accounts payable, payrolls, etc.

(iii) Dividend policy.

(iv) Forecast of accrued and deferred charges.

(v) Rate of income and other taxes.

(b) STATEMENTS TO BE INCLUDED IN BUDGET

(i) Projected monthly statement of cash receipts and disbursements.

(ii) Monthly manufacturing, trading and profit and loss estimates.

(iii) Monthly pro forma balance sheet.

(iv) Monthly surplus budget.

## *EXAMINERS' COMMENTS*

1. Several candidates tended to generalize to the extent that at times they lost sight of the requirements of the question.

2. Several candidates overlooked the important point that budgets must be prepared on a monthly or quarterly basis if they are to be used as a means of control.

3. Candidates commonly based their requirements regarding production costs on the fact that standard costs would be used, but failed to state what attempt would be made to estimate variances.

4. Many candidates apparently thought that the budget department would prepare the budget based upon past performance adjusted for future expectation, with little or no reference being made to the other departments.

## PROBLEM 3

### Final Examination, October 1953

*Accounting I, Question 2 (15 marks)*

The E Co. Ltd. manufactures three products, D, F and C, of which C is a by-product.

Products D and F sell for $700 and $200 per ton respectively. By-product C sells for $100 per ton.

The four ingredients from which all three products are made are used in the following proportions at the costs indicated:

R — 10% costs $100 per ton
S — 20% " $ 50 " "
T — 30% " $ 60 " "
X — 40% " $ 30 " "

Warehousing and handling charges are calculated at 10% of the cost of each ingredient.

The plant is divided into four manufacturing departments. In departments 1, 2, and 3 products D and F are processed. By-product C is processed in Department 4 after the split-off.

Of the ingredients mixed, only 75% by volume passes from Department 2 to Department 3, the remainder going to Department 4 where ½ of this 25% is recovered as by-product C, the balance being entirely waste.

Department 3 produces 40% product D and 60% product F from each batch processed.

The following are the costs of direct labour per ton of product handled and the percentages of departmental factory service expense to direct labour:—

| Department | Direct labour per ton handled | Percentage of factory service expense to direct labour |
|---|---|---|
| 1 | $25 | 75% |
| 2 | 15 | 100% |
| 3 | 50 | 50% |
| 4 | 10 | 100% |

Selling expenses attributable to by-product C are 20% of its selling price.

**Required:**

Prepare schedules showing the gross profit per ton sold of each of products D and F. Base your computations on the assumption that 10 tons of ingredient R are put into production.

## A SOLUTION

*Assumptions*:

1. That the main products are credited with the selling price of the by-product less the costs of further processing and selling expenses.
2. That costs are allocated between the joint products on a "weighted average basis". (See allocation of cost of joint products, below)

STATEMENT OF COSTS OF PRODUCTION OF JOINT PRODUCTS D AND F
(Assuming that 10 tons of ingredient R are put into production)

| | | |
|---|---|---|
| *Material costs* | | |
| 10 tons R at $100 | $ 1,000 | |
| 20 tons S at 50 | 1,000 | |
| 30 tons T at 60 | 1,800 | |
| 40 tons X at 30 | 1,200 | |
| | | $ 5,000 |
| Warehousing and handling charges (10%) | | 500 |
| *Direct labour costs* | | |
| Dept. 1 100 tons at $25 | 2,500 | |
| Dept. 2 100 tons at 15 | 1,500 | |
| Dept. 3 75 tons at 50 | 3,750 | |
| | | 7,750 |
| *Factory service costs* | | |
| Dept. 1 75% of $2,500 | 1,875 | |
| Dept. 2 100% of $1,500 | 1,500 | |
| Dept. 3 50% of $3,750 | 1,875 | |
| | | 5,250 |
| Total cost of processing 100 tons of raw material | | 18,500 |
| *Deduct* costs absorbed by by-product C | | |
| Selling price 12½ tons at $100 | 1,250 | |
| *Less* selling expenses (20%) $250 | | |
| labour and factory service, Dept. 4 500 | | |
| | 750 | |
| | | 500 |
| Total cost of production of 75 tons of joint product | | $18,000 |

**Allocation of cost of joint products**

| | | cost per ton |
|---|---|---|
| *Product D* — 30 tons | | |
| $\frac{30 \times 700}{30{,}000} \times 18{,}000$ | $12,600 | $ 420 |
| *Product F* — 45 tons | | |
| $\frac{45 \times 200}{30{,}000} \times 18{,}000$ | 5,400 | 120 |

THE E CO. LTD.

CALCULATION OF GROSS PROFIT PER TON SOLD

| | Product D | Product F |
|---|---|---|
| Selling price | $ 700 | $ 200 |
| Cost of sales | 420 | 120 |
| Gross profit | $ 280 | $ 80 |

**Editor's note:**

Other possible bases of allocation of cost of joint products would be (i) in ratio of volume produced and (ii) in ratio of selling price per ton.

## *EXAMINER'S COMMENT*

**A number of candidates did not reduce the cost of the joint products by the profit on the by-product.**

# THE TAX REVIEW

*Melville Pierce, B.A., LL.B., Editor*

[1954] APRIL Part I

## SOME CURRENT INCOME TAX QUESTIONS

By Melville Pierce, B.A., LL.B.

OUR Income Tax Act imposes a tax on all or part of the income for each year of every person who was at any time in the year resident in Canada, employed in Canada or carried on business in Canada[1] or (if he is or did none of these things) if he received income from certain sources in Canada in the year.[2] The basic charge, however, is upon the income of a person from all sources in each year.[3]

### I. INCOME

Until recently it was supposed that a gain accruing to a person from an isolated transaction or some sideline activity was not truly income. Well, that view is pretty well exploded now. That is not to say, of course, that every gain which accrues to a person in a year is necessarily taxable. It must still be "income", and the concept of "income" in the tax law, stemming from the meaning of the word in ordinary usage, postulates, as I understand it, a source which produces or is capable of producing recurring fruits. You may think that I am contradicting what I said above, that the gain from an isolated transaction may still be income. Let me explain.

#### Sources of Income

The two main sources of income, if not the only sources, are property and labour or, of course, a combination of the two. By labour I mean any form of human energy or ingenuity. What is characteristic of both property and labour from our point of view is their capacity for producing recurrent fruits. Traditionally, of course, property has been the source of income, but in modern times one form of activity has equalled and indeed surpassed it, namely trade, industry and commerce in all its forms. Until fairly recently the income tax collector was content to look to these and to employment (i.e. regular continuous employment) as the sources of income, but in the last few

[1] ITA 1953, s. 2
[2] ITA 1953, s. 106
[3] ITA 1953, s. 3

An address to the Society of Industrial and Cost Accountants, Ottawa, January, 1954

decades, first in Britain, then in the United States, and more recently here, the growing requirements of the State for revenue have led him to search for added sources of income. Of the result we are learning more each day.

In the various applications of human energy and ingenuity the tax collector has found what he sought. It has been held, for example, that the writer of a book, though the writing of books be not his normal occupation, is taxable on the proceeds, on the footing that the writing of a book is a product of human energy which is not diminished by the writing of the book, and that the ability to write a book is akin to capital employed in a business which by law must be kept intact.[4] It has been held that a lawyer who receives a reward for guaranteeing a loan for his clients is taxable thereon, as being a reward for services rendered.[5] In a recent case which got to our Supreme Court, it was held that the chairman of a bondholders' committee who received, by way of remuneration for his services, a share of the fee paid the committee's solicitor, even though the committee chairman had no right to be remunerated, was taxable on the amount as being a reward for services which he had rendered in fact.[6]

### The Newer Attitude

Whereas income was looked on as the recurring fruits of capital or labour or of both combined, and of course still is, the newer attitude looks less to the actual recurrence of the fruits than to the capacity of the source to produce recurring fruits. Thus it is that profits from isolated transactions are often held to be income. It may be worth adding that the profit made from a single case of purchase and resale of property is, however, regarded as income only if the circumstances of the transaction possess a commercial character, for unless the purchase and re-sale is performed in the way of business there is no source to which to attribute the profit and it is a mere enhancement in value of the property sold. As Mr. Justice Rowlatt once said:

> A person who buys an object which subsequently turns out to be worth more than he gave for it, and which he sells, does not thereby make a profit or gain for income tax purposes. But he can organize himself to do that in a commercial way, and the profits which emerge are taxable profits, not of the transaction, but of the trade.[7]

Of course our Act, copying the British Act, now ensures that one transaction of purchase and sale is enough if it is in the nature of trade, that is to say, possesses commercial characteristics.[8] This provision makes it clear that a taxpayer who takes but one step in the waters of trade will almost certainly find himself caught in the tax gatherer's greatly expanded net.

This new attitude to income is proving somewhat disconcerting to many taxpayers. For example, the Supreme Court of Canada has indicated in recent decisions[9] that a gain made by an incorporated company quite outside its usual or normal business will be held taxable unless the gain was unquestionably from the disposal of an undoubted capital asset[10] or perhaps of an investment of free funds.

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[4] *Hobbs* v. *Hussey*, (1942) 24 T.C. 153 (Lawrence J.)

[5] *Ryall* v. *Hoare* [1923] 2 K.B. 447 (Rowlatt J.)

[6] *Goldman* v. *MNR* [1953] Tax Rev. 46 (S.C.C.)

[7] *Graham* v. *Green* [1925] 2 K.B. 37.

[8] ITA 1953, s. 139(1)(e)

[9] *Atlantic Sugar Refineries Ltd.* v. *MNR* [1942] Tax Rev. 100; *MNR v. Independence Founders Ltd.* [1953] Tax Rev. 175

[10] *Sutton Lumber Co.* v. *MNR* [1954] Tax Rev. 133

To sum up, I think it is generally true that the greater the amount of effort and ingenuity expended by a person in the pursuit of gain the more certain it is that any resulting gain will be regarded as income, namely, the fruit of the energy and ingenuity expended, and that on the other hand to the extent that the gain is fortuitous, the result of mere chance, the less likely it is that it will be regarded as income. In each case it is a question of fact or degree rather than one of law. For example, it has been held that a gambler's winnings from betting on horse races at starting prices are not income in his hands, notwithstanding that he devotes all his time and ingenuity to that activity, but that a bookmaker's profits are income in his.[11] The distinction, of course, is the large fortuitous element in the bettor's profits and the purely commercial nature of the bookmaker's. It is, of course, a very fine distinction, but it does serve to illustrate the point.[12]

## II. INCOME OF A PERSON

Unlike the British Act our Income Tax Act does not tax income from a source but rather income of *a person* from all sources.[13] Thus whereas the British Act, for example, imposes a tax on the income of a partnership from its business, that is to say, the tax is paid by the firm on income of the firm before it is allocated to the partners, our Act, on the other hand, taxes the individual partners on their shares in the income of the partnership after it has been allocated to them.[14] For the most part this difference between our basis of imposing a tax at the destination and the British basis of taxing it at the source is of little significance, since in the vast majority of cases income from a source emerges in the hands of the person whose income it is. Income from an employment, from a business, from property, is in most cases paid to the employee, the business proprietor, and the property-owner respectively.

### Transmissions of Income

But there are exceptions. Take the case of a trustee, for example, who is legally entitled to the income from trust property but is obliged to distribute it to a beneficiary. For that case our Act contains a specific provision, that the amount paid or payable to the beneficiary shall be deducted from the trustee's income.[15] There is, however, no like provision to cover other situations where one person is the recipient of income from a source subject to an obligation to pay it to another. In other words, where one person receives or is entitled to receive income but is obliged to pay part or all of it to another, whose income is it? Is it income of the person through whose hands it passes or of the person who receives it beneficially or, possibly, is it the income of both?

Now the answer to that question depends very largely upon how the obligation arose. The rates of taxation are graduated, rising to 80% on very large incomes, and there is consequently a very strong incentive for an affluent taxpayer to divert some of his income to persons who would in any event be the objects of his bounty and in whose hands it will bear a lower tax than it would in his. The Act accordingly contains a number of specific provisions to prevent the avoidance of tax through a volun-

[11] *Graham* v. *Green, ubi supra*
[12] See *Partridge* v. *Mallandaine* (1886) 2 T.C. 179
[13] ITA 1953, s. 3
[14] ITA 1953, s. 15(1)
[15] ITA 1953, s. 63(4)

tary diversion of income by a taxpayer which falls short of being an absolute and outright alienation of his income.

(1) A taxpayer who transfers property to his spouse or to a child under 19 remains taxable on the income from such property.[16]

(2) For tax purposes a wage or salary paid by a taxpayer to his spouse is not recognized.[17]

(3) Nor will a partnership between spouses be recognized except as a matter of ministerial grace.[18]

(4) Any assignment of income by one person to a person with whom he was not dealing at arms length is ignored unless there is a simultaneous transfer of property from which the income is derived. (And, of course, if the transferee is the spouse of the transferor or a child under 19 even that will avail nothing).[19]

(5) A settlement by way of trust of one person's property or the income from property on another person has no effect under the Tax Act if the disposition of the property can be modified or the settlor retains any power of appointment or any control over the trust property.[20]

(6) A taxpayer who directs or concurs in the payment to another of amounts which would be included in computing the former's income, either for his own benefit or to benefit the other, remains taxable on the amount notwithstanding the assignment.[21]

So you see a taxpayer cannot easily escape taxation by assigning his income to someone else or by voluntarily assuming an obligation (whether by way of declaration of trust or otherwise) to pay what would otherwise be his income to another.

### Alienation or Disposition?

But there is another type of case altogether, where one person transfers property or income from a source to some other person and at the same time imposes an obligation on the transferee to pay part or all of the income from that source to another. In such cases the transferee has a legal right to *receive* the income but he has no control over the *disposition* of that income — as a result not of his own act but of the act of another. Instances of this kind arise quite frequently under trusts and wills. A person may convey property to A in trust to receive the rents and profits therefrom and pay it to other persons whom the settlor desires to benefit. There is no difficulty there; the Act specifically provides that in such a case the ultimate beneficiaries are alone taxable on the income to which they are entitled under the trust.[22] But there is no specific provision in the Act to deal with similar cases which arise otherwise than by way of trust. For example, a devise of real property to a son of the testator subject to payment of a specified portion of the income therefrom to a daughter, or a bequest of the income from certain property to the son subject to payment of a specified portion of it to the testator's daughter. In each case the son is entitled to receive all the income from the property but has no freedom of disposition over the portion of it which must be paid to the testator's daughter. Apart from statute or authority to the contrary, one would not suppose that the portion of the income received by the son under an obligation to pay it to the daughter is the income of anyone but the daughter. As income from a source it is true that it emerges first in the hands of the former but in view of the obligation attaching to him it does not, surely, emerge in his hands as *his* income. Nevertheless cases

[16] ITA 1953, s. 21(1), s. 22(1)
[17] ITA 1953, s. 21(2) and (3)
[18] ITA 1953, s. 21(4)
[19] ITA 1953, s. 23
[20] ITA 1953, s. 22(2)
[21] ITA 1953, s. 16
[22] ITA 1953, s. 63(4)

of this sort have caused the greatest difficulty for the tax authorities and the Courts, largely, I think, because of the confusion between income from a source and income of a person. As a consequence, it is extremely difficult to follow the reasoning of some of the decisions.[23]

What appears to be the principal obstacle to arriving at the solution I have indicated stems, I think, from the Departmental concept that the income from a source is the income of the person in whose hands it first emerges, a doctrine they regard as being enshrined by what is now section 12(1)(a) which provides: "In computing income, no deduction shall be made in respect of (a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer".

### The Bouck Case

Without labouring this question further, it seems to me that the Departmental concept was given its quietus by the Supreme Court of Canada a year or two ago when, with two of its members dissenting, it decided the case of *Bouck* v. *M.N.R.*[24] In that case a testator left the income of his estate to his widow to be used by her in her sole discretion for the maintenance of herself and for the maintenance and education of her children. The Supreme Court held that all of the income from the estate was not the income of the widow, though she received it all, but only the portion of it which she used for her own maintenance was her income and that the amount expended on the maintenance and education of her children was the income of the children. That case certainly seems to support the general proposition that income from a source is not income of the person who receives it or who is entitled to receive it if he is legally obliged to pay it to or for the benefit of someone else, in other words, if he has no beneficial interest in it, and further that section 12(1)(a) has no bearing on the matter.[24a]

It remains to be seen, however, to what extent and how rapidly the view which underlies this decision will percolate down.

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[23] See *F* v. *MNR* [1950] Tax Rev. 88; *Peter Estates Ltd.* v. *MNR* [1951] Tax Rev. 156; *Saunders* v. *MNR* [1951] Tax Rev. 157; *Brown* v. *MNR* [1952] Tax Rev. 70; *Wilson* v. *MNR* [1953] Tax Rev. 111

[24] [1952] Tax Rev. 129

[24a] In an Indian appeal *Bejoy Singh Dudhuria* v. *C. of T.* (*Bengal*) [1933], where a legatee had been ordered by the Court to pay an annuity to his step-mother, the Privy Council held that the amount of the annuity was deductible in ascertaining the amount of the legatee's income under the relevant statute. The Board agreed with the Court below that the legatee's liability to his step-mother was not of the same kind as his liability to provide for his wives and daughter and that the position was the same as if he had received the assets actually bequeathed upon the terms that those assets were charged with an annuity for the maintenance of the step-mother. It was not, they agreed, a case of a charge created by the legatee for the payment of debts which he had voluntarily incurred. They concluded: "When the Act by s. 3 subjects to charge 'all income' of an individual it is what reaches the individual as income which it is intended to charge. In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to that extent diverted his income from him and has directed it to his step-mother; to that extent what he receives for her is not his income. It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands." (Thanks to H. Heward Stikeman, Q.C.)

## III. INCOME OF A PERSON FOR A YEAR

The income tax is imposed on the income of a person for a year,[25] a condition which poses no difficulties for persons whose income is from employment or from property or from any source other than from trade or commerce. Income from practically all sources of income other than trade is almost always received as a net sum, but income from a business is rarely received net. Income from a business for a year—at least if the business is of any size — is a notion or a concept rather than anything tangible. It is the difference between the receipts actual and estimated attributable to the business operations of the period and the expenditures made or incurred attributable to those operations, and the actual time of receipt and expenditure is more or less irrelevant to the ascertainment of the amount of the profit from a business for a year.

### Periodic Business Profit

Unfortunately, those who are not trained accountants or who are unfamiliar with accounting principles find it hard to grasp the concept of periodic business profit which is held by accountants and commercial men, and this has led to a great many difficulties. One of the principal present difficulties had its beginning quite awhile ago. You will recall that the IWTA defined income as "profits and gains received" from various sources.[26] Some years ago, the Supreme Court of Canada held[27] that in view of this definition an executor of a will was taxable on arrears of remuneration payable to him under the will when he received the cash and not in the earlier years when he was entitled to receive it. That decision has had some far-reaching consequences. The executor in that case was not a professional executor as is, e.g., a trust company, and it may be doubted whether the Supreme Court, when it pronounced the reasons for judgment, was laying down a rule that the receipts *of a business* are to be included in computing the income of the year in which they are received. However, in two cases which came soon after in the Exchequer Court, the President of that Court read that judgment as if it did lay down such a rule, with results that you will all recall. In the *Robertson* case[28] he held that the receipts of a business must be included in computing the income of a business in the year in which they are received rather than that in which they are earned so far as such receipts are not held in trust or by way of deposit. In the *Trapp* case[29] he held that an expenditure is deductible only in the year in which it is made and that the IWTA did not permit the Minister to assess income on the earnings or accrual system of accounting. Surprisingly enough, however, the President of the Exchequer Court in a recent case upheld the right of the Anaconda Brass Company to deduct the cost of its inventory over the various financial periods in which the inventory was sold on the assumption that the latest inventory purchased was the first to be sold, i.e. without any regard to the time when the company made the expenditure to acquire the inventory.[30]

In view of the fact that the new Income Tax Act now authorizes the accrual method of computing the income of a business for a year[31] these past events may, you think, be of historical interest only. But unfortunately the ghosts of

[25] ITA 1953, s. 2
[26] IWTA s. 3
[27] *Capital Trust Corp.* v. *MNR* [1937] SCR 192
[28] *Robertson Ltd.* v. *MNR* [1944] CTC 75
[29] *Trapp* v. *MNR* [1946] CTC 30
[30] *Anaconda American Brass Ltd.* v. *MNR* [1952] Tax Rev. 171
[31] ITA 1953, s. 14

the *Trapp* and *Robertson* cases still walk and I may add that they are accompanied by many other spirits of similar nature. Let me illustrate.

### Some Legal Decisions

In one Exchequer Court case it was held that a supplier of merchandise in containers was entitled to a deduction in the year of sale for refunds on containers which would be returned in a subsequent year.[32]

That decision was very satisfactory to accountants, but recently another Judge of the same Court has held that a wholesale newsdealer is not entitled to a deduction in the year of sale for refunds on periodicals which will be returned in a subsequent year.[33] That view is not in accordance with the accounting concept of periodic business profits. In that case the learned Judge also said that the Act required all receivables to be brought into income in the year of sale subject only to an allowance for doubtful debts. Soon afterwards, however, one of the judges of the Income Tax Appeal Board held that a salesman of subscriptions to magazines, payable by instalments, was not bound to bring the receivables into account in the year of sale but could bring the instalments into account as and when collected.[34] There seems to be a contradiction there. In an earlier case in the ITAB the other two members of the Board held, on the contrary, that the instalment method of reporting income was not permissible under the Act.[35] And in still another case it was held by one of the latter that where long term second mortgages were taken by a commercial builder as part consideration for houses sold the Minister had the right to decide whether the whole amount of the mortgage should be taken into income in the year of sale at a valuation or that the payments thereon should be brought in as and when received.[36]

These various conflicting decisions on the fundamentals of profit computation only confound confusion. And, as you all know, the ITAB has held in a series of judgments that money received for goods and services to be rendered in the future must be taken into the income of the year in which it is received, without any deduction whatever.[37] Some of these decisions have, as you know, been reversed or modified by Parliament through the enactment last year of what is now section 85B of the revised Income Tax Act. It cannot be said, however, that the amended law accords with commercial accounting principles or that it will resolve all the problems which may arise. If anything, it will give rise to as many difficulties as it will solve.

### Some More Divergences

May I mention a few more instances of divergence between the tax law and the commercial attitude towards profits of a business for a year.

The Chairman of the ITAB has held that where a taxpayer claims a reserve for doubtful debts he must, if called upon, establish the doubtfulness of each specific debt in respect of which he makes a claim.[38] Commercially speaking, that is a virtual impossibility for many large-scale businesses. On the matter of inventory valuation the Tax De-

[32] *Western Vinegars Ltd.* v. *MNR* [1935] CTC 325 (Angers J.)

[33] *MNR* v. *Sinnott News Co.* [1952] Tax Rev. 209 (Cameron J.)

[34] 90 v. *MNR* [1953] Tax Rev. 86 (Fordham)

[35] *Kent* v. *MNR* [1952] Tax Rev. 121 (Monet and Fisher)

[36] *Himmen* v. *MNR* [1951] Tax Rev. 135 (Fisher)

[37] *Capital Transit Ltd.* v. *MNR* (Fisher); *64* v. *MNR* (Fisher); *J. J. Joubert Ltee* v. *MNR* (Fordham); [1952] Tax Rev. 213; *London City Dairies Ltd.* v. *MNR* (Fisher) [1953] Tax Rev. 33

[38] *81* v. *MNR* [1953] Tax Rev. 90

partment has contended — it may still do for all I know — that the LIFO method is not a permissible method of inventory valuation because it is not a method of determining either the cost price of goods sold or their market price.[39] Yet I understand that the Department accepts the retail store method and, I believe, the base stock method, for neither of which is any pretence made that it represents either cost price or market value.[40] You can draw your own moral from this. Turning to depreciation, the effect of the capital cost allowance regulations,[41] so far as corporations are concerned, is virtually to compel them to misstate their profits for any year if the maximum tax allowance is desired, as it almost always is, of course. And the reason for that requirement is an unexplained mystery.

Let me mention a few more decisions concerning a somewhat different aspect of the problem of ascertaining periodic business profits. In one case an oil exploration company received a subvention for exploration purposes which it ought to have included in its income for the year but did not. Two years later it expended moneys on exploration. The ITAB held that having failed to include the subvention as income in the year it was received the company could not claim a deduction of an equivalent amount expended on exploration in a later year although it would otherwise have been deductible as an expense of that year.[42] Just a few weeks ago, however, the President of the Exchequer Court said in another case[43] that the validity of an assessment must be determined in the light of the existing facts and the applicable law, and, in particular, that its validity does not rest on what the taxpayer may have done in the past or what the taxing authorities allowed him to do. There seems to be some conflict there.

There have been recently a number of decisions which bear on the question of just what are the profits of a business for a year? Must a gain result from the actual trading operations of the year or is any gain which arises in the course of the business subject to taxation?

In one case a shipbuilder sustained a loss on a shipbuilding contract, but a guarantor assumed one-half of the loss and paid that amount to a creditor of the shipbuilder in abatement of a loan made to the latter to provide him with working capital. The majority of the ITAB held that the reduction of the debt was income of the contractor's business, though Mr. Fisher dissented on the ground that the reduction was in respect of capital.[44] That case, I should imagine, will go to a higher Court, and the decision will be of interest.

### Foreign Exchange Profits

On the same general subject, however, there are a number of cases on the question of foreign exchange profits. Recently, trading companies have made substantial gains by paying off foreign indebtedness following either a devaluation of sterling or the return of the Canadian dollar to parity with the U.S. dollar following the war. In one of these cases Mr. Fisher held that a company which made such a gain by paying off previously incurred trade debts after the restoration of the Canadian dollar to par with the U.S. dollar was taxable on the gain, as being a gain clearly connected with the carrying on of its business.[45]

[39] See *Anaconda American Brass Ltd.* v. *MNR, ubi supra*

[40] See ITA 1953, s. 14(2) and ITReg. 1800

[41] See ITReg. 1100(4)

[42] *Okalta Oils Ltd.* v. *MNR* [1953] Tax Rev. 160 (Fordham)

[43] *Eli Lilly (Canada) Ltd.* v. *MNR* [1954] 1 Tax Rev. 201

[44] *78 v. MNR* [1953] Tax Rev. 64

[45] *Eli Lilly (Canada) Ltd.* v. *MNR* (*sub nom. 12* v. *MNR*) [1951] Tax Rev 90

That decision was recently affirmed by the President of the Exchequer Court of Canada who said that the profit might be called a foreign exchange profit although in point of fact there was no purchase or sale of any foreign exchange in that case whatever.[46] Strangely enough, in a more recent case where a purchaser of goods in Britain procured a loan of sterling to pay for them and subsequently made a profit by repaying the sterling loan after the devaluation of sterling, Mr. Fisher held that the gain was a foreign exchange profit but that it was not taxable since the taxpayer was not in the business of dealing in foreign exchange and that the gain was therefore in respect of capital.[47] There seems to me some discrepancy here which goes to the root of the question: what is the profit from a business for a year?

These cases demonstrate, I think, that the tax administration and the Courts are far less concerned than is the accountant with the attribution of periodic business income to its appropriate periods in accordance with established accounting principles and methods, and that if a profit is made in the course of a business, even outside the normal and usual operations of the business, it will be held to be income of the business for one year or another,[48] it doesn't matter very much which. The only exception of which I am reasonably sure is a profit made on the disposal of a capital asset and then only if it was purchased as a capital asset, employed for no other purpose than as a capital asset and it was never contemplated that it would be turned to account otherwise than by employment as a capital asset.[49] It may be also that an investment of free funds by a commercial enterprise can be disposed of at a profit without attracting tax.

### Rule of Deduction

On the other hand, while the scope of taxation has been greatly extended in recent years, by Parliament, by the Administration, and by the Courts, the rule governing the deductibility of business expenditures has been narrowed. The most apparent, though perhaps not the real, reason for this is s. 12(1)(a) of the Act which prohibits the deduction of every outlay or expense unless it is laid out for the purpose of gaining or producing income from a business or property. It is upon this enactment that the Courts have fastened in establishing the rule that only those expenses are deductible which are made or incurred in the process of earning the income of the business,[50] that is, directly connected with the ordinary business operations of the taxpayer.[51] Certain subordinate rules have been evolved also, e.g., that an expenditure made anterior to the commencement of business is prohibited as is also an expenditure made to acquire or *to protect*[52] an advantage of enduring benefit to the trade. You will note the rather striking contrast between the principles which appear to govern the inclusion of receipts in computing the income from a business for a year and those which allow the deduction of expenses in that computation.

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[46] *Eli Lilly (Canada) Ltd.* v. *MNR* [1954] 1 Tax Rev. 201

[47] *137* v. *MNR* [1954] 1 Tax Rev. 203

[48] See also *Atlantic Sugar Refineries Ltd.* v. *MNR, ubi supra,* and *Independence Founders Ltd.* v. *MNR, ubi supra*

[49] *Sutton Lumber Co.* v. *MNR, ubi supra; B. & A. Motors Ltd.* v. *MNR* [1953] Tax Rev. (Cameron J.)

[50] *Dom. Natural Gas Co.* v. *MNR* [1941] SCR 19

[51] *Montreal L. H. & P. Co.* v. *MNR* [1944] AC 126

[52] *Dom. Natural Gas Co.* v. *MNR, ubi supra*

## CONCLUSION

I have endeavoured to discuss some of the fundamental tax questions of the present day. It seems to me that my discussion points to the most fundamental question of all, namely, the basic philosophy underlying the Canadian tax system in the Canadian democratic body politic. It does seem to me that the tax philosophy of those entrusted by the people through Parliament with the collection of taxes from the people is founded on an attitude which is a compound of distrust of the taxpayer and of lack of self-confidence on the part of the tax collector. That seems to me at least to be fundamentally wrong, for the Canadian taxpayers (who are of course the Canadian people) are perhaps as honest and as socially conscious as any other. There is no more need to distrust us in the execution of our responsibilities as taxpayers than there is in any other aspect of our national life.

# RECENT TAX CASES

### Gairdner Securities Ltd. v. M.N.R.

*(Supreme Court of Canada, Kerwin, Rand, Locke, Cartwright and Fauteux JJ., January 26, 1954)*

**Business Profit — Company — Investment Dealer Business — Sale of assets — Isolated purchase and sale of securities — Whether profit of business or realization of investment — E.P.T. Act 1946**

Appellant company was incorporated in 1930 to carry on the business of a dealer in securities, and it did so until 1938, in which year, owing to the depression, it was unable to meet the requirements of the investment dealers' association of which it was a member, and in that year it caused the incorporation of a new company to which it sold all its physical equipment, records, and goodwill in return for stock in the new company. Appellant retained its portfolio of securities subject to the liabilities outstanding against them for bank advances, and from 1938 until 1944 it liquidated a substantial number of those securities in a number of trading transactions. In 1944 it sold a number of securities to an associated company, but still retained a substantial number; in 1945 it made no sales. In all it made 125 purchases and 200 sales of securities between May 1, 1938 and December 31, 1946. In 1944 it purchased stock in a malting company with the object of obtaining control of that company in order to enable appellant's controlling shareholder to introduce his sons to industrial management. The malting company was then recapitalized and eventually in 1946 appellant sold its shares therein at a substantial profit, upon which it was assessed to excess profits tax in that year. The assessment was affirmed by Cameron J. in the Exchequer Court [1952] Tax. Rev. 206, and the company appealed to the Supreme Court of Canada.

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Articles and cases in *The Tax Review* are cited by reference to the year and Part in which the case or article appears. Two parts will be published each year: Part I comprises the issues of *The Canadian Chartered Accountant* from January to June, and Part II the issues from July to Dec.

*Held,* the particular transaction was part and parcel of the general trading operations of the company conducted from 1938 to the end of 1946. The fact that the company ceased to be a member of the investment dealers association in 1938 was irrelevant; it could still independently deal as it pleased in security transactions. The purchases and sales of securities in the period mentioned bore on their face the imprint of a course of action pursued with a view to making a profit through their ultimate result. The contention that all these transactions represented mere changes of investments as distinguished from the merchandising of securities and that the profit was chargeable to capital must be rejected. Investments, in the sense urged, look primarily to the maintenance of an annual return in dividends or interest: substitutions in the securities take place, but they are designed to further that primary purpose and are subsidiary to it. On the facts of this case there cannot be any real doubt that there was no such dominant purpose here. As to the purchase and sale of the malting stock, while one of the dominant objects in its purchase may have been to enable the introduction of the dominant shareholder's sons to the business there was also at least one other purpose made evident, namely to sell the stock if a favourable opportunity arose. While ordinarily a business involves a repetitive series of transactions for making a profit from the whole, there can be a business of taking over, by means of stock control, run down industries, building them up and disposing of them, and that pattern of action can be included in a group of cognate transactions operating in any form.

*Appeal dismissed*

## M.N.R. v. L. D. Caulk Co. of Can.
## M.N.R. v. Goldsmith Bros. Smelting & Refining Co.

*(Supreme Court of Canada, Rinfret C.J.C., Kerwin, Rand, Kellock, Estey, Locke and Fauteux JJ., January 26, 1954)*

**Business Profits — Legal Expenses — Costs of defending trade practices in combines investigation and criminal proceedings — Deductibility of — IWTA s. 6(1)(a)**

In 1947 both respondent companies, which were in the dental supply business, were invited by the Commissioner under the Combines Investigation Act, R.S.C. 1927, c. 26 to make representations before him in connection with an investigation he was conducting into an alleged combine in the dental supply business in Canada. The companies did so, employing lawyers for the purpose. In 1948 both companies were charged with conducting an unlawful combine in restraint of trade under Cr. Code s. 498 and incurred costs in defending themselves against the charge, of which they were acquitted, their acquittal being affirmed on appeal. The Commissioners' investigation and the criminal proceedings dealt with the day-to-day business practices of the respondents, and it was established that the adverse publicity resulting from the charges led to a substantial decrease in their business. In their income tax returns for 1947 and 1948 respondents claimed deductions of amounts paid by them in those years as solicitors' fees for representing them before the Commissioner in 1947 and for solicitors' and counsel fees for representing them at their trial and on the appeal therefrom, both in 1948. The Minister disallowed the deductions claimed,

and on appeal to the ITAB ([1950] Tax Rev. 209) their appeals were allowed, the judgment being affirmed by Cameron J. on an appeal by the Minister to the Exchequer Court ([1952] Tax Rev. 34).

*Held,* the Minister's appeal to the Supreme Court of Canada must be dismissed. The expenditures in question were deductible; they were not prohibited by IWTA s. 6(1)(a), being "wholly, exclusively and necessarily laid out for the purpose of earning the income" within the meaning of those words in that paragraph. *Kellogg* v. *M.N.R.* [1943] S.C.R. 58, followed. *Dominion Natural Gas Co.* v. *M.N.R.* [1941] S.C.R. 19 distinguished as being a case concerned with expenses incurred to preserve a capital asset.

*Per* Rinfret, C.J.C. and Rand J.: The agreement alleged to have been unlawful purported to regulate day-to-day practice in the conduct of the respondents' business; it formed no part of the permanent establishment of the business; it was a scheme to govern operations rather than to create a capital asset; and the payment to defend the usages under it was a beneficial outlay to preserve what helped to produce the income. The payment arose from what were considered the necessities of the practices to the earning of the income. As in the *Kellogg* case the expenses in question were connected with the day-to-day usage in marketing the companies' products.

*Per* Kerwin and Fauteux JJ.: The legal fees were not concerned with the preservation of a capital asset. Moreover the fees in question were necessary in a legal sense and so are outside the prohibition of IWTA s. 6(1)(a). *Riedle Brewery Ltd.* v. *MNR* [1939] S.C.R. 253, applied.

*Per* Kellock and Locke JJ.: As in the *Kellogg* case the expenses incurred by the respondents in contesting a challenge of their right to employ a certain trade practice were "working expenses", "expenses incurred in the process of earning the income", those phrases representing the test employed by the Supreme Court of Canada in the *Dom. Natural Gas Co.* case. The income was earned by the employment of that trade practice, and it is immaterial that whereas in the *Kellogg* case the challenge to its use was by a private party in this case the challenge was by the Crown. The expenses in question were not merely indirectly related to earning the income in question but were "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of s. 6(1)(a). (Estey J. concurred in the dismissal of the appeal).

*Appeal dismissed*

## Dominion Taxicab Association v. M.N.R.

*(Supreme Court of Canada, Kerwin, Rand, Locke, Cartwright and Fauteux, JJ., February 15, 1954)*

**Business Profits — Capital or Income — Contributions made by taxi owners to service association — Whether absolute property of Association or deposit merely — True construction of transaction — Objects for which contributions intended — Deposit subject to equal contingent liability not profit — ITA (1949)**

Appellant Association was incorporated without share capital under the Quebec Companies Act in July 1949, its membership to consist of the three applicants for incorporation and others who might become members. Amongst the purposes for which the Association was incorporated was the purchase of the business and assets of an unincorporated taxicab association, the establishment of services

for the Association's members, the acquisition of any property, franchise, rights, etc. which might be to the Association's advantage, and the purchase, sale, rental or exchange of all immoveable property necessary for its purposes. During 1949 the Association entered into contracts with the owners of 81 taxicabs and received $500 in respect of each taxicab under contracts which provided that each member (the taxicab owner) deposited the $500 as an entrance fee (*droit d'entrée*) to obtain the privilege of putting a taxi into service in the Association and that the entrance fee should become the absolute property of the Association upon the withdrawal of the member unless both parties to the contract agreed that it should be transferred to a new acquirer, and the Association undertook to regard the entrance fee as a deposit upon which interest should be paid when its management should think fit. The Association was assessed to income tax on the entrance fees ($40,500) received by it in 1949 and appealed, contending that the entrance fees were merely loaned to the Association whilst the Minister contended that the entrance fees became the absolute property of the Association, being part of the consideration for its agreement to supply services, the remaining consideration therefor being furnished through monthly payments of the members. The appeal was dismissed by the ITAB (Mr. Monet) [1951] Tax Rev. 227, which held that the sums in question did not remain the sole property of the members and that they were not a capital receipt but an income receipt in the hands of the Association, *viz.*, a fee in payment for services. The Association appealed to the Exchequer Court of Canada, where its appeal was dismissed by Archibald J. [1953] Tax Rev. 84, who held that the entrance fees became the sole property of the Association free of any liability and that it was irrelevant that the sums were to be used for the purpose of acquiring the business of an unincorporated taxicab association. The Association appealed to the Supreme Court of Canada.

*Held,* the appeal must be allowed: no part of the sum in question was income of the Association.

*Per* Cartwright J. (Kerwin, Locke and Fauteux JJ. concurring): On the true construction of the contract between the Association and each of its members, and on the evidence, the entrance fees did not become the absolute property of the Association in 1949, but as each deposit was received by the Association and became a part of its assets there arose a corresponding contingent liability equal in amount. Under the terms of the contract there was not an outright payment of the entrance fee to the Association but the deposit with it of that sum though the circumstances under which a member might require the return of his deposit were not described in the contract: the Association only became absolute owner of the deposits when two conditions were fulfilled (1) the member left the Association, and (2) the parties failed to agree on a satisfactory successor to him.

> "It is the submission of the respondent that the sum . . . is profit derived from the appellant's business during the taxation year and so is liable to tax under the combined effect of secs. 2(1), 3(a) and 4 of the ITA. The expression 'profit' is not defined in the Act. It has not a technical meaning and whether or not the sum in question constitutes profit must be determined on ordinary commercial principles unless the provisions of the ITA require a departure from such principles. In the case at bar the main question is as to the respective rights of the appellant and its members in regard to the deposits . . . It is well settled that in considering whether a particular transaction brings a party within the terms of the ITActs its substance rather than its form is to be re-

garded . . . While the method of bookkeeping adopted by the parties is not conclusive either for or against the party sought to be charged with tax, I am of opinion that . . . the appellant rightly treated the $40,500 as a deferred liability to its members, and that unless and until the necessary conditions were fulfilled to give absolute ownership of a deposit to the appellant and to extinguish its liability therefor to the depositing members, such deposit could not properly be regarded as a profit from the appellant's business. (*Diamond Taxicab Assoc.* v. *MNR* (Ex.) [1952] Tax Rev. 132, (affirmed by the Supreme Court without written reasons) distinguished, the sums there in question having been paid outright to the Association as part of the consideration for the services it rendered, and no question of a deposit arose.)

*Per* Rand J.: The contributions of $500 made by the members, both in the intention of the subscribers and of the Association, furnished the funds required by the Association for capital purposes, *viz*,. to acquire the business and assets of an unincorporated taxicab association, acquire garages, immoveable property, etc. The contributions were obviously to enable capital assets to be acquired and were limited in their application to that purpose, and accordingly cannot be held to be income.

(*Diamond Taxicab Assoc.* v. *MNR*, *supra*, distinguished on the ground that the moneys paid to the Association had been paid as commuted compensation for future services.)

*Appeal allowed*

## Miron & Freres Ltd. v. M.N.R.

(*Exchequer Court of Canada, Fournier J., February 22, 1954*)

**Non-Arms Length Transaction — Capital Cost Allowances — Sale of property by minority shareholder to company — Assessed as non-arms length transaction — Onus of rebutting assessment on taxpayer — ITA (1950) s. 20(2), 127(5)(a)**

In 1948 GM bought a farm containing a valuable stone quarry for $90,000 and in 1949 sold it to appellant company for $600,000, and the company subsequently operated the quarry. In its tax return for 1950 the company claimed capital cost allowances in respect of the quarry based on the capital cost to it (after deducting $50,000 for the residual value of the land), but the Minister invoked ITA s. 20(2) and would only allow capital cost allowances based on the capital cost of the quarry to GM. At the time of the sale of the property to the company GM and his five brothers owned all but 3 of appellant's 1,000 issued shares of capital stock, GM owning 200, one brother owning 200, and each of the others owning 150 (less 3 shares in the case of one). GM was also president of the company. The company appealed to the ITAB, but its appeal was dismissed by Mr. Fisher (*sub nom. 112* v. *MNR* [1953] Tax Rev. 167) on the ground that GM as a shareholder was "one of several persons by whom [appellant company] was directly or indirectly controlled" within the meaning of ITA s. 127(5)(a) and that the sale of the property by GM to the company was therefore a transaction between persons not dealing at arms length within the meaning of ITA s. 20(2), and accordingly that the company was only entitled to capital cost allowances on the property based upon the capital cost thereof to GM. The company appealed to the Exchequer Court of Canada.

*Held*, whatever may be the interpretation of the words "a corporation and one of several persons by whom it is directly or indirectly controlled" in s. 127(5)(a), the assessment having been based on the assumed fact that GM was one of several

persons by whom the appellant company was controlled the onus was upon the company to prove by evidence that such was not the fact: it was for appellant to demolish the basic fact on which the taxation rested: *Johnston* v. *MNR* [1948] S.C.R. 489, followed. Proof that GM was a minority shareholder in the company and also its president (and presumably a director) was not sufficient to establish that he may not have been one of several shareholders by whom the company was controlled.

Whether or not a company is controlled by a group of shareholders is a question of fact. A minority shareholder in a company is not in every case one of several persons by whom the company is controlled. The words "one of several persons" in s. 127(5)(a) do not, however, require that sufficient shares to control a company be held jointly by several persons of whom the person dealing with the company is one.

*Appeal dismissed*

## Cerny v. M.N.R.

*(Exchequer Court of Canada, Fournier J., February 22, 1954)*

**Companies — Loan to Shareholder — Whether undistributed income on hand at date of loan — Presumption of continuance of company's financial position as of last balance sheet — Onus of proof — IWTA (1946) s. 18**

Cerny was one of the principal shareholders of a company whose fiscal period ended on August 31 of each year. The financial statements of the company for the fiscal period ending August 31, 1946 showed that the company had on hand on that date undistributed income to the amount of $77,426. On September 3, 1946 the company advanced to Cerny by way of loan $26,500. He was assessed to income tax in respect of this amount for 1946 pursuant to IWTA s. 18 which provides that a loan or advance by a corporation to a shareholder shall be deemed to be a dividend to the extent that the corporation has undistributed income on hand. Cerny appealed, contending that there was no evidence that the company had undistributed income on hand on the date of the loan to him, *viz.*, three days after the date of the financial statements. His appeal was dismissed by Mr. Monet in the ITAB ([1952] Tax Rev. 212) on the ground that Cerny had failed to satisfy the onus of proving conclusively that the company had no undistributed income on hand at the time of the loan to him, which would have been easy for Cerny as one of the principal shareholders to do. Cerny appealed to the Exchequer Court of Canada.

*Held,* dismissing the appeal, it must be presumed that the financial situation of the company existing on August 31, 1946 continued until September 3, 1946 (*vide Phipson on Evidence,* 9th ed., p. 107) and in view of this and the presumed validity of an assessment until the contrary is proved (*Johnston* v. *MNR* [1948] S.C.R. 486, esp. per Rand J. at p 489), appellant was bound to adduce evidence to rebut the presumption of the continuance of the company's financial position as of August 31, 1946.

*Appeal dismissed*

# INCOME TAX APPEAL BOARD CASES

*Fabio Monet Esq., Q.C. (Chairman), Cecil L. Snyder Esq., Q.C. (Assistant Chairman) W. S. Fisher Esq., Q.C. and R. S. W. Fordham Esq., Q.C.*

## Boland v. M.N.R.

*Deductions — Property subdivided into lots — Sale of houses and lots — Not carrying on a business — Municipal taxes on unsold lots not deductible from mortgage interest on houses sold — ITA 1948 s. 12(1)(a)*

In 1922, Boland, with two other men, bought property outside a city, which they were unable to sell even though it was subdivided into lots, and accordingly they arranged with a builder to build houses thereon from time to time which they then sold. Some houses were built and sold, the last sale being made in 1947, since which time no further houses were built but some lots were sold. Of the houses which were sold, appellant had taken back mortgages from which income was derived by him, and which he reported in his tax returns. In his return for 1949 he paid municipal taxes of $605 in respect of the vacant lots in the subdivided property, and claimed that amount as a deduction from the income derived by way of interest on the above mortgages.

*Held* (Mr. Fisher), the municipal taxes so paid by him were not expenses incurred in the carrying on of a business by him but were expenses in connection with unproductive property and therefore barred from deduction by ITA s. 12(1)(a).

*Ont, Jan 6/54* *Dismissed*

**Editor's Note:** According to many cases a person who builds and sells houses on property subdivided into lots may well be carrying on a business, in which case his profits are taxable as the profits of a business. In this case it is, however, held, by implication, that the appellant's activities did not constitute the carrying on of a business, though no reasons are given for that conclusion. If he were carrying on a business of building and selling houses and of selling lots on the subdivided property, no doubt the taxes in question would have been deductible. It is also apparently held that where property is subdivided and interest is derived from money owing by purchasers of individual lots, that the income so derived is income only from the lots sold and not from the property as a whole even though, from the facts related, it would appear that the property was one tract which had been arbitrarily converted into smaller portions for purposes of sale. It is a rather difficult case.

## Stromberg v. M.N.R.

*Employment — Travelling expenses of employee — Manager of shoe store — Expenses of calling on trade to obtain information — ITA s. 11(6)*

Stromberg was employed by a merchandiser to manage a shoe department, being remunerated by a salary of $3,900 a year plus a commission based on the sales made. Stromberg was given a free hand to operate his department and his time was his own. He visited certain shoe factories, cultivated the friendship of sales managers there, visited premises of competitors and studied merchandise where he could find it on display, his object in all this being to obtain shoes of the most saleable kind from wholesalers and jobbers. To enable him to follow this course he purchased a car, and in the taxation year claimed a deduction of his automobile expenses including depreciation of the car, totalling $1,327, in ascertaining his income for the year, his commissions for the year being $1,425.

*Held* (by the full Board), he was not entitled to claim the deduction. ITA s. 11(6) is not confined to the expenses

of persons employed in selling property, but extends to those of persons employed in the negotiating of contracts, and hence covers those incurred by Stromberg. The deduction is, however, excluded for non-compliance with the condition of para. (b) since Stromberg was not "ordinarily required to carry on the duties of his employment away from his employer's place of business": he was ordinarily in the retail store. Moreover, expenses in visiting other stores, etc. merely to note styles and cultivate trade acquaintances would not be deductible as there was no buying or negotiating of contracts involved in that conduct.

*Que, Jan 7/54* *Dismissed*

Editor's Note: The Minister had pointed out that appellant's commissions were from retail sales whilst the expenses which he sought to deduct from them were in connection with buying, and contended that buying expenses were not deductible under s 11(6). The Board pointed out that s. 11(6) referred not only to the selling of property but also to the "negotiating of contracts", and that this last might include buying as much as selling, but it went on to say that some of the expenses here were not connected with buying but with noting new shoe styles and cultivating trade acquaintances and that these were not within the enactment. This commentator would merely observe that the words "selling of property" and "negotiating of contracts" relate only to the nature *of the employment* and not to the nature *of the expenses* sought to be deducted. The expenses which are deductible by a person employed in connection with the selling of property or negotiating of contracts (and who satisfies the other conditions of the subsection) are "amounts expended by him in the year for the purpose of earning the income from the employment" up to the amount of his commissions.

### Siblock v. M.N.R.

*Evidence — Sufficiency of proof — Allegation that payment made to B*

Siblock, a sub-contractor in the construction of lateral sewers, paid $2300 in cash to an engineer employed by the principal contractor for rental of certain equipment used by him in carrying out his sub-contract, but the proof of such payment rested solely on his oral testimony that he had paid the money together with his testimony, that the engineer (who did not testify) had the records of the payments, and that the engineer had inserted the details of such payments in Siblock's income tax return. The Minister disallowed a deduction of the rental payments for insufficient proof.

*Held* (Mr. Fisher), there was no reason to doubt Siblock's oral testimony, and in view of his assertion that the engineer had inserted the details of the payments in appellant's tax return, the amount of the payments did not rest solely on appellant's claim but also partly on the figures supplied by the recipient of the payments.

*Ont, Jan 11/54* *Allowed*

Editor's Note: While a court is no doubt entitled to accept the sworn evidence of a witness as adequate proof unless the law requires corroboration (which it does not in income tax appeals), where the issue before the court is whether or not A had or had not done a certain thing (in this case, paid money to B), it is difficult to see how A's assertion that he had paid it is made any more credible by his further assertion that B had furnished him the details of when it was paid.

### 144 v. M.N.R.

*Foreign Exchange Profit — Trading company — Line of credit with U.S. company — Goods purchased from operating divisions of U.S. company — Alteration in rate of exchange — Whether profit trading profit or on borrowed capital*

In August, 1950 appellant company, which had an overdraft amounting to more than $6,000,000 at its bank, ar-

ranged with its U.S. parent company for a line of credit up to $2,000,000 in U.S. funds, later increased to $5,000,000, upon which appellant was free to draw without restriction. Appellant did not transfer any of the funds to Canada but used its line of credit solely to purchase goods in the U.S. from the parent company's various operating divisions, all of which operated autonomously, selling their products independently and collecting their own accounts. On making a purchase from one of the parent company's operating divisions appellant instructed the parent company to issue a cheque in payment to that division, and itself gave a note to the parent company for the amount borrowed which bore interest at 2% or 2¼% per annum, payable quarterly. Appellant's books of account reflected its purchases of goods from the U.S.A. in Canadian dollars, which was at a discount with the U.S. dollar until the end of 1950 when the Canadian dollar rose in value in terms of the U.S. dollar. At the close of its 1950 financial year, which coincided with the calendar year, appellant calculated the amount of its liability in respect of U.S. purchases at the current rate of exchange, which was some $64,675 less than the amount entered in its accounts in respect of those purchases at the time they were made during the year. The Minister, in the view that such amount was chargeable as income, assessed appellant to income tax thereon. Appellant appealed.

*Held* (Mr. Fisher), the line of credit obtained by appellant from its U.S. parent was borrowed capital, and the profit resulting to appellant from the reduction in the premium on U.S. funds at the end of 1950 was a capital profit; it did not arise out of the trading operations of appellant, the goods purchased in the U.S. having been paid for promptly by appellant soon after delivery of the goods. Even though the goods were paid for out of the moneys borrowed the loan was not an ordinary day-to-day transaction of appellant. The relationship between appellant and its U.S. parent in respect of the loan was that of borrower and lender and it was out of this relationship that the profit arose. The evidence showed that it was not part of appellant's business to deal in foreign exchange.

*Feb 8/54* *Appeal allowed*

Editor's Note: In the *Eli Lilly* case, where a Canadian company purchased goods from its American parent when the U.S. dollar was at a premium, but settled the liability when the Canadian dollar was at par with the U.S. dollar, it was held by Mr. Fisher (*sub nom 12* v. *MNR* [1951] Tax Rev. 90) that the company had made an exchange profit clearly connected with the carrying on of its business which was a part of its trading profit for the year in which it settled the liability, a profit arising out of the conduct of its day-to-day business. That judgment was recently affirmed by the President of the Exchequer Court of Canada [1954] I Tax Rev. 201. In this case the facts are very similar, but Mr. Fisher holds that the profit was made in respect of borrowed capital, and apparently the basis for that holding is that the goods were purchased from autonomous operating divisions of the U.S. supplier while the credit was extended by the head office of the U.S. supplier. It is not altogether clear from the judgment whether the "operating divisions" were merely branches of the U.S. company or were themselves limited companies and therefore distinct legal entities. If the latter is the case this judgment follows the reasoning of Mr. Fisher in *137* v. *MNR* [1954] 1 Tax Rev. 203; if the former is the case it is very hard to see the distinction between this case and the *Eli Lilly* case.

### Joggins Coal Co. v. M.N.R.

*Expenses — Deductibility of — Costs incurred in tax appeal—Not laid out to earn business income—ITA s. 12(1)(a)*

Appellant company incurred legal and accounting expenses in litigating an in-

come tax dispute with the Minister of National Revenue through the Exchequer Court and the Supreme Court of Canada following the Minister's disallowance of depletion allowances claimed by appellant company in respect of coal mined by it in 1939, 1940 and 1941. Appellant was successful in the Supreme Court of Canada in 1950, and sought to deduct the amount paid to its lawyers and accountants in 1949 and 1950 for their services in connection with the dispute.

*Held* (Mr. Monet), the costs and expenses incurred by a taxpayer in connection with an income tax appeal are not laid out or expended for the purpose of earning the taxpayer's profits from its business and so are prohibited from deduction by ITA s. 12(1)(a). *Allen* v. *Farquharson Bros. & Co.*, 17 T.C. 59; *Smith's Potato Estates Ltd.* v. *C.I.R.* [1948] A.C. 508; *Montreal Coke Mfg. Co.* v. *MNR* (P.C.) [1944] C.T.C. 94, applied; *Anglo-Canadian Oil Co.* v. *MNR* [1947] Ex. C.R. 63, mentioned.

*N.S., Sep 25/53* *Dismissed*

**Stratton's Executors v. M.N.R.**

*Gift Tax—Exemption of donatio mortis causa—Requisites of—ITA (1950) s. 101(4)*

Stratton, an elderly retired business man, suffered a stroke on June 27, 1949 and was told by his doctor that if he did not take care of himself he might die. Although a recalcitrant patient Stratton made a partial recovery from the stroke. In February 1950 he received three cheques totalling $39,360 from an insurance company representing the proceeds of paid-up policies on his life. Stratton endorsed one cheque and he and his wife endorsed the other two, and he then had his wife drive him to the local bank where, on arrival, he told her to deposit the cheques in her name, but said nothing further so far as his wife could recollect. While the money remained on deposit the wife did not draw any of it for her own benefit, but when Stratton suffered a second stroke in April 1950 and was taken to hospital, where he died in September, she withdrew moneys to pay his hospital and medical expenses and his church subscription, after first obtaining her solicitor's advice to do so. The wife was the principal beneficiary of Stratton's will, his estate being a substantial one. The Minister assessed a gift tax of 16% on the amounts deposited in the wife's name as above described, and Stratton's executors appealed contending that there had been a *donatio mortis causa,* which was expressly exempt from gift tax by ITA s. 101(4).

*Held* (Mr. Fordham), all the requisites to a *donatio mortis causa* were present, and the amount in question was not subject to gift tax. The gift was intended to take effect only after Stratton's decease, there was delivery to the donee of the subject-matter of the gift, and the gift was made in *contemplation* of death if not in expectation of it. *Cain* v. *Moon* [1896] 2 Q.B. 283 at p. 286; *Re Fanning* [1923] 3 D.L.R. 925 per Middleton J. at p. 926; *Rosenberger* v. *Public Trustee* (1945) 12 Ins. L.R. 34 (Ont.), discussed.

*Ont, Oct 6/53* *Allowed*

**Rous & Mann Ltd. v. M.N.R.**

*"Control" of a company—Capital cost allowances—Non-arms length transaction —Power to acquire control not equivalent to actual control—ITA s. 127(5)(b)*

In June 1944 A and B, the controlling shareholders of the A Co., entered into an agreement with the company's five key employees, providing for the incorporation of a new company to acquire the plant and equipment of the A. Co. The authorized capital of the new company was to consist of 1000 first preference

shares carrying voting rights, 200 non-voting second preference shares and 400 common shares. A and B undertook to subscribe for all the first preference shares for $25,000, and the five employees agreed to take up all the common shares and 105 of the second preference shares for $12,625. It was also agreed that the new company would enter into certain obligations regarding the redemption of the first preference shares, the payment of dividends and interest on the purchase price of the assets acquired, and that in the event of default A and B would have the right to bring about the winding-up of the new company. Upon incorporation of the new company in July, 1944, the five employees subscribed for all the shares they had agreed to subscribe for, but A and B initially subscribed for only one first preference share each, and they did not subscribe for the remainder of the first preference shares until some months after the new company had purchased the plant and equipment of the A Co., although A was elected president and treasurer of the company at the first meeting of the directors in July and B was elected vice-president and secretary at the same meeting. In assessing the company to tax for 1950 the Minister would allow capital cost allowances in respect of the plant and equipment acquired from the A Co. on the basis of the cost of the equipment to the A Co. rather than the actual cost of the equipment to the new company (which was higher), contending that this was the combined effect of *ITA* s. 127(5)(a) and s. 8(3) of the *IT Amdt Act,* 1949 (2nd sess.), c. 25. Section 127(5) provides that the following persons shall be deemed not to deal with each other at arms length, viz.,

(a) a corporation and a person or one of several persons by whom it is directly or indirectly controlled;

(b) corporations controlled directly or indirectly by the same person.

*Held* (Mr. Fordham), "control" of a company, be it direct or indirect, signifies the power exercisable by registered shareholders at a meeting, and consequently until A and B acquired the majority of the shares in appellant company they did not control it notwithstanding their ability to obtain control whenever it suited them to do so. Mere ability to acquire control is quite different from actually having control. Mere *de facto* as distinct from *de jure* control, which requires the registration of the shares, is insufficient. *B. W. Noble Ltd.* v. *C.I.R.* (1926) 12 T.C. 911, p. 926; *F. A. Clark & Sons Ltd.* v. *C.I.R.* (1941) 29 T.C. 49 at p. 65; *MNR* v. *Wright's Can. Ropes Ltd.* [1947] A.C. 109 at p. 118; *B.A. Tobacco Co.* v. *C.I.R.* (1941) 29 T.C. 49 at p. 61; *Vancouver Towing Co.* v. *MNR* [1946] Ex. C.R. 623; *J. Bibby & Sons Ltd.* v. *C.I.R.* (1945) 29 T.C. 167; *Himley Estates Ltd.* v. *C.I.R.* (1932) 17 T.C. 367; *Fed. Com'r of T.* v. *W. Aust. Tanners &c Ltd.* (1945) 8 A.T.D. 25 at p. 28; *Purdom* v. *Doherty* (1927) 30 O.W.N. 425; *Glasgow Expanded Metal Co.* v. *Anderson* (1923) 2 A.T.C. 317, discussed. Consequently s. 127(5)(a) did not apply to the circumstances of this case. Apart from this enactment, the evidence adduced on behalf of appellant company satisfied the court that A and B did not endeavour to bring pressure to bear on their five employees, and that the relationship between A and B on the one hand and the five employees on the other was at arms length.

*Allowed*